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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Petitioner,

v.

HARRIS TRUST AND SAVINGS BANK,
as Trustee of the Sperry Master Retirement Trust No. 2,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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December 22, 1992

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Question Presented

Whether the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.*, apply to any of the assets held in the General Accounts of insurance companies under group annuity contracts issued to pension plans that provide for guaranteed benefits.

Parties

The parties to the action below were petitioner John Hancock Mutual Life Insurance Company ("Hancock"); respondent Harris Trust and Savings Bank ("Harris Trust"); counterclaim defendant Chase Manhattan Bank, N.A. ("Chase"), which was succeeded as trustee of the Sperry Master Retirement Trust No. 2 on October 1, 1987, by Harris Trust; and third-party defendants Sperry Corporation ("Sperry") and The Retirement Committee of Sperry Corporation ("Sperry Retirement Committee").

Hancock is a mutual insurance company; it does not have any parent companies or subsidiaries to list pursuant to Rule 29.1.

In 1986, Sperry merged with Burroughs Corporation and became Unisys Corporation ("Unisys"). The Sperry Retirement Committee was succeeded by the Unisys Pension Investment Review Committee. Hancock is informed and believes that shares of Unisys and shares of Chase are publicly traded. Additionally, petitioner is informed and believes that Harris Trust is acting as a party only in its capacity as trustee of the Sperry Master Retirement Trust No. 2 and is not otherwise affected by the outcome of this litigation, and that the Bank of Montreal is a parent of Harris Trust.

Hancock is not aware of any other parent companies or subsidiaries to list pursuant to Rule 29.1.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner John Hancock Mutual Life Insurance Company ("Hancock") respectfully petitions for a writ of certiorari to review so much of the judgment of the United States Court of Appeals for the Second Circuit as (a) determined that the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* ("ERISA"), apply to certain assets held by Hancock in its General Account by virtue of the group annuity contract issued to respondent Harris Trust and Savings Bank ("Harris Trust") known as "GAC 50"[1] and (b) reversed the judgment of the United

[1] Although the original contractholder of GAC 50 was The Sperry Corporation (together with various affiliated companies), that entity has undergone

(*Footnote continued*)

States District Court for the Southern District of New York dismissing the action.

Opinions Below

The opinion of the court of appeals is reported at 970 F.2d 1138 (A-1[2]). The two opinions of the district court are reported at 722 F. Supp. 998 ("*Harris I*") (A-21), and 767 F. Supp. 1269 ("*Harris II*") (A-63); the judgment of the district court was entered on August 16, 1991 (A-89).

Jurisdiction

The judgment of the court of appeals was entered on July 30, 1992 (A-19). The court of appeals denied Hancock's petition for rehearing and suggestion for rehearing *in banc* on September 23, 1992 (A-91). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). This petition is filed within the time allowed by law.

Statutes and Regulations Involved

The pertinent statutory provisions and regulations are set forth in the Appendix beginning at A-93.

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numerous changes in name and corporate form since 1941. For convenience, however, that entity will be referred to throughout this petition as "Sperry," and the employee benefit plan sponsored by that entity will be referred to as the "Plan." By an amendment to the contract effective May 1, 1978, the rights of the contractholder were transferred from Sperry to Chase Manhattan Bank, N.A., as Trustee of The Sperry Rand Master Retirement Trust No. 2 ("Chase"). Chase, acting in its capacity as trustee of the Plan, was originally the named plaintiff in this lawsuit. As of October 1, 1987, Chase was replaced as trustee by Harris Trust and Savings Bank ("Harris Trust"), and Harris Trust has been substituted as plaintiff in place of Chase. Chase and Harris Trust in their capacities as trustee are referred to herein as "Harris Trust."

[2]References to pages of the Appendix are cited as "A-", followed by the page number.

Statement of the Case

Hancock seeks review of a decision of the Court of Appeals for the Second Circuit that has construed the fiduciary responsibility provisions of ERISA to apply to routine insurance company business practices that have historically been subject solely to state regulation. The Second Circuit decision is in direct conflict with a recent decision of the Third Circuit on precisely the same issue and also conflicts with 18 years of consistent administrative pronouncements on that issue by the Department of Labor ("DOL"), the agency charged by Congress with implementing and enforcing ERISA. The Second Circuit's decision, which would create dual and conflicting regulation of the business of insurance under state and federal law, has caused substantial confusion and uncertainty in the insurance industry and threatens disruption of longstanding insurance company business practices.

Insurance companies hold in their General Accounts billions of dollars that have been paid as premiums under group annuity contracts issued to ERISA-regulated pension plans. These premiums have been combined in their General Accounts with the premiums received by them under other types of insurance contracts, such as individual and group life, health and disability policies, and these commingled funds have been invested and reinvested by insurers on an undifferentiated basis in various types of assets. General Account assets are an insurance company's general corporate assets and are used to pay its costs of operation and support all its obligations to its policyholders and other creditors.

An insurance company's obligations to its policyholders, as well as the administration and management of its General Account, are governed by contract provisions and state insurance laws and regulations. An insurance company is not a fiduciary at common law to its pension plan or other policyholders.

The Second Circuit held in this case that an insurance company's General Account is subject, in certain circumstances, to

ERISA's fiduciary duty rules. ERISA contains a complex set of rules governing the conduct of a fiduciary, including the obligation that a fiduciary

> discharge his duties with respect to a plan solely in the interest of the [plan's] participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries. . . .

29 U.S.C. § 1104(a)(1). (A-94) Under ERISA, a fiduciary is any person who "exercises any discretionary authority or control respecting management or disposition" of a pension plan's assets. 29 U.S.C. § 1002(21)(A). (A-93) An insurance company is not a fiduciary to a pension plan under ERISA unless the insurer has discretionary authority or control over the plan's assets.

Congress failed to define the term "plan assets" in ERISA, a significant omission later addressed by the DOL. In ERISA's "guaranteed benefit policy" exception, however, Congress expressly provided that assets held by an insurance company under a "policy or contract that provides for benefits the amount of which is guaranteed by the insurer" will not be deemed to be plan assets:

> In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. . . .
>
> * * *
>
> (B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

29 U.S.C. § 1101(b)(2). (A-94) Under that exception, to the extent that an insurer has issued a contract that provides for guaranteed benefits, the funds held by the insurer under the contract are deemed not to be "plan assets," and ERISA's fiduciary provisions do not apply.

In this case, the Second Circuit acknowledged that GAC 50 is a group annuity contract that provides for guaranteed benefits and that, in part at least, it comes within the "guaranteed benefit policy" exception (A-8). The court concluded, however, that the exception would not apply to the extent that any assets held by Hancock under the contract are "not referable to guaranteed benefits" (A-14). To that extent, according to the court, GAC 50 does not come within the exception, and Hancock has fiduciary duties under ERISA with respect to the administration and management of those assets (A-10).

The Second Circuit's ruling is erroneous, because it is contrary to the statute's language, Congress' intent and the DOL's longstanding interpretation. In addition, the court's decision, as a practical matter, is incapable of implementation. First, Hancock's commingled General Account assets are not referable to or identifiable with any particular policy or contract, or any part of a policy or contract; if Hancock is subject to ERISA fiduciary duties with respect to any of its General Account assets, it is, in effect, subject to ERISA duties as to all those assets. Second, General Account assets held by Hancock in connection with GAC 50 cannot be segregated or separated from the General Account without violating the express terms of GAC 50, which require that the funds under the contract be placed in the General Account. Third, requiring Hancock to act with regard to any General Account assets "solely in the interest of" a particular contractholder would cause it to violate state law requirements that it deal fairly and equitably and in a nondiscriminatory manner with respect to all policyholders.

1. **The Contract at Issue.**

GAC 50 is a common type of General Account group annuity contract issued to pension plans. In consideration of premiums

paid by the plan, the insurance company guarantees unconditionally that it will pay pension benefits to specified plan participants in fixed amounts determined by the plan.[3] To the extent that the premiums paid to the insurer, combined with any income or dividends allocated to the contract, exceed the cost of the benefits that the contractholder has directed the insurer to provide, the contractholder may elect to have the insurer provide additional guaranteed benefits.[4]

The premiums paid by a contractholder – in this case, Harris Trust – under a General Account group annuity contract become part of the insurer's General Account. The guarantees provided by the insurer under the contract are backed by the entirety of the assets in its General Account, which consists of all the company's commingled corporate funds and assets (with the exception of certain Separate Account assets that are not at issue here[5]). The General Account is available to satisfy all of the company's obligations to policyholders, including all individual

[3] Typically, pension plan participants are entitled to receive fixed monthly benefit payments from the plan, which may be paid directly by the plan. If a pension plan enters into a group annuity contract with an insurance company, however, the insurer, in exchange for the premiums, will guarantee, and pay, the benefits to the designated plan participants. Under GAC 50, Hancock's guarantee of payment would not be affected or terminated even if (i) there were a subsequent breach of the contract by Harris Trust or (ii) the funds held in connection with the contract were insufficient to provide the benefits Hancock was obligated to pay. Although GAC 50 was amended on a number of occasions, Hancock's guarantees to plan participants and beneficiaries under the contract have not changed in any way.

[4] If such an excess exists, the contract may colloquially be said to have "free funds" (A-5).

[5] An insurance company Separate Account is a segregated fund or pool of assets established pursuant to contract with one or more customers, including, typically, employee benefit plans. *See* 29 U.S.C. § 1002(17). Under Separate Account arrangements, assets held are invested separately, and the results of the investments are passed through to the customer directly, sometimes in the form of variable annuity benefits.

and group life, health, disability and annuity contracts. None of these assets is segregated, identified with or attributable to any particular contract or obligation. An insurance company's General Account is also its business operating account. General Account funds comprise all of the funds (and the only funds) available to the company for the conduct of its routine business activities, such as the payment of salaries, rent, taxes and other ordinary business expenses.

Contracts like GAC 50 are "participating" contracts, *i.e.*, they share, or "participate," in the investment experience of the General Account by receiving through complex income allocation formulas a portion of the General Account's net investment income. In part, therefore, participating contracts are allocated income on the basis of the return realized by the insurance company on its General Account investments as a whole.

Integral to the insurance relationship embodied in General Account contracts are the transfer of risk from the policyholder to the insurer and the spreading of that risk among a vast number of insurance customers. The premiums paid by those customers are pooled by the insurance company in its General Account and are invested to achieve the greatest possible return, consistent with investment safety and the requirements of applicable state insurance laws and regulations. The aggregate of all these invested premiums then stands behind all the insurer's obligations. The policyholders, of course, do not have any specific assets associated with or referable to their respective policies, to any portion of these policies, or to any specific benefits provided under the policies. Instead, they have contractual rights *vis-à-vis* the insurer that are supported by all the assets of the company's General Account.

Through the pooling of premiums, pension plans and other purchasers of insurance contracts are able to transfer and share risk among themselves in exchange for a guarantee of benefits and other contractual guarantees. Because the pooled assets in the General Account are available to satisfy all of those obligations, the insurer is able to underwrite policies that guarantee

a result acceptable to all policyholders, with no one policyholder suffering the adverse results that would surely confront some of their number if all were to stand alone.

2. Harris Trust's Claims.

In its original complaint, Harris Trust alleged some 13 causes of action, which sounded generally in common law breach of contract and common law breach of fiduciary duty, relating to Hancock's administration of GAC 50. No mention was made of ERISA. Almost one year later, Harris Trust amended its complaint to allege, as its first cause of action, that all of Hancock's conduct previously alleged to have violated Harris Trust's rights at common law also violated ERISA.[*] Harris Trust's 13 common law causes of action were reasserted in the amended complaint, with minor revisions. The relief demanded in the amended complaint was in all substantial respects identical to that sought in the original complaint.

Throughout the lawsuit, Harris Trust offered veritable laundry lists of wrongs Hancock had allegedly committed in violation of the common law and ERISA, including breach of various provisions of GAC 50. The heart of Harris Trust's case, however, involved a challenge to a plethora of Hancock's business policies and practices. In general, Harris Trust's ERISA allegations centered on claims that Hancock had breached its fiduciary duties by its failure to administer its General Account "solely in the interest of" the Plan. Harris Trust claimed, for example, that Hancock's investment decisions (including its use of General Account assets to invest in its home office building), its method of allocating income earned on the assets in its General Account, and its determinations regarding dividends were improper because they were not undertaken solely to benefit GAC 50.

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[*] The amended complaint alleged jurisdiction in the district court based upon 28 U.S.C. §§ 1331 and 1332, and 29 U.S.C. § 1132. Jurisdiction was originally alleged solely on the basis of 28 U.S.C. § 1332.

Hancock denied that it had breached any provision of GAC 50 and maintained that it had no fiduciary duties either at common law or under ERISA with regard to GAC 50 or the operation of its General Account. Hancock also argued that it was not subject to ERISA's fiduciary provisions, because GAC 50 is a "guaranteed benefit policy" within the meaning of 29 U.S.C. § 1101(b)(2). (A-94)

3. The District Court's Two Decisions.

Following the completion of discovery in the district court, the parties submitted cross-motions for partial summary judgment, based upon an agreed statement of facts, addressed solely to the applicability of ERISA to the claims asserted by Harris Trust. In *Harris I*, Judge Patterson held that Hancock is not a fiduciary with respect to assets held in its General Account under GAC 50, because the contract in its entirety comes within the "guaranteed benefit policy" exception, and dismissed all of Harris Trust's purported ERISA claims (A-61 to A-62). Hancock then moved for summary judgment dismissing all of Harris Trust's common law claims. In *Harris II*, Judge Patterson granted that motion (A-63), and final judgment was thereafter entered dismissing the action in its entirety (A-89).

4. The Second Circuit Decision.

In its appeal to the Second Circuit, Harris Trust sought reversal of the district court's conclusion that ERISA's fiduciary provisions did not apply to its claims. With one exception, it abandoned on appeal all its common law claims (A-2 to A-3). The court of appeals, in all respects but one, affirmed the lower court judgment (A-2).

In reversing the district court, the court of appeals first held (A-8) that GAC 50 is a "guaranteed benefit policy" within 29 U.S.C. § 1101(b)(2). The court further held, however, that the contract came within the exception only with respect to assets "referable to guaranteed benefits" (A-14) and that assets not so "referable" (*i.e.*, the so-called "free funds") were assets of the Plan as to which Hancock was to be considered an ERISA

fiduciary (A-14). The court also determined that Hancock was not a fiduciary in exercising its contract rights under GAC 50 (A-13) and that Hancock had not breached GAC 50 as a matter of common law (A-13 to A-14).

The Second Circuit identified the principal issue to be whether the existence of "free funds" affected GAC 50's status as a "guaranteed benefit policy" (A-8). The court held that, to the extent that "free funds" are not immediately required to guarantee benefit payments to Plan participants (though they could be used for that purpose in the future) and because they are subject to fluctuation based upon the insurer's investment performance, Hancock has ERISA fiduciary duties with respect to the administration and management of such funds (A-10 to A-11).

The Second Circuit took note of the recent decision of the Third Circuit in *Mack Boring and Parts Corp. v. Meeker Sharkey Moffitt*, 930 F.2d 267 (3d Cir. 1991), in which that court held that a contract similar to GAC 50 in its essential terms was a "guaranteed benefit policy" in its entirety, because the contract "made provision for 'guaranteed benefits to plan participants at some finite point in the future'" (A-11). Although GAC 50, like the contract in *Mack Boring*, provided that "free funds" could be used by Harris Trust to require the future payment of additional guaranteed benefits, the Second Circuit rejected the reasoning of the Third Circuit on this point. Instead, it relied upon an earlier Seventh Circuit decision, *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Ins. Co.*, 698 F.2d 320 (7th Cir. 1983), which held that an insurance contract could not be a guaranteed benefit policy unless it provided for a fixed rate of investment return (A-9 to A-10). Having concluded that there are "no guarantees" with regard to the "free funds" under the contract and that GAC 50 does not provide for a fixed rate of return, the Second Circuit held that Hancock "should be subject to fiduciary responsibility" (A-10).

Reasons for Granting the Writ

The Second Circuit decision in this case conflicts squarely with the Third Circuit's decision in *Mack Boring*. It also contradicts the DOL's longstanding interpretation of the statute, *viz.*, that funds placed in an insurance company's General Account "shall not be considered plan assets" (A-96), and creates a conflict between federal and state law.

Assets in an insurance company's General Account are available to satisfy all the company's obligations to its policyholders and creditors. To assure that General Account assets are invested prudently and that insurers deal evenhandedly with all classes of policyholders, the States, in accordance with the national policy underlying the McCarran-Ferguson Act (A-93), have developed a broad framework of insurance company regulation. The Second Circuit decision, however, obligates insurers to manage at least some General Account assets for the exclusive benefit of some policyholders.

The Second Circuit holding has created profound uncertainty concerning the legal standards that will govern the administration and management of vast amounts of insurance company assets. Pension plans throughout the nation have paid hundreds of billions of dollars to insurers under participating General Account contracts indistinguishable from the contract at issue here. Companies like Hancock, which transact business nationwide, cannot now anticipate whether their routine business practices will be judged by standards set by the Second Circuit, the Third Circuit, the Seventh Circuit or, indeed, by state or federal law. As one commentator has observed, the Second Circuit decision "could affect the investment of all the assets held in insurance company general asset accounts" and "leaves the legal terrain pitted with uncertainty."[7]

[7] Chernoff, *Appeals Court Ruling Clouds Insurance Issue*, Pensions & Investments 31 (Aug. 17, 1992). Counsel for Harris Trust has remarked that "he would expect the insurance industry to be 'extraordinarily concerned' about the ruling." *Id.* Another practitioner has noted that application of ERISA's fiduciary standards to the insurance industry "could create 'incredible

(Footnote continued)

I.

THERE EXISTS A CLEAR CONFLICT AMONG THE CIRCUITS

The decisions of the court below, the Third Circuit in *Mack Boring* and the Seventh Circuit in *Peoria Union* present fundamentally different interpretations of the "guaranteed benefit policy" exception. The Second Circuit held that a group annuity contract is not a "guaranteed benefit policy" to the extent that there are "free funds" under the contract. In contrast, the Third Circuit held that a contract with "free funds" is a "guaranteed benefit policy" in its entirety so long as it " 'provided' guaranteed benefits to plan participants at some finite point in the future." 930 F.2d at 273. The Seventh Circuit posits a wholly different standard: an insurance contract is a "guaranteed benefit policy" only if the insurance company has guaranteed a "fixed payout" to the contractholder. 698 F.2d at 327.[8] These starkly different views of the exception cannot be reconciled.

The Third Circuit properly understood the plain meaning of 29 U.S.C. § 1101(b)(2) and Congress' intent to exempt General Account contracts from ERISA's fiduciary requirements. Unlike the Second Circuit, that court correctly refused to construe the "to the extent that" language of the exception so as to impose fiduciary duties with respect to some, but not all, General Account assets held under a guaranteed benefit policy. *Mack Boring*, 930 F.2d at 274. It analyzed the relationship of the sentences in section 1101(b)(2) to give meaning to the whole section and concluded that the "to the extent that" language was intended to distinguish between contracts that provide variable benefits

conflicts of interest'" and "is going to be a major setback for the insurance industry." Greenwald, *Ruling May Widen Insurers' Liability for Pension Assets*, Business Insurance 30 (Aug. 10, 1992).

[8] Upon rehearing in *Peoria Union*, the Seventh Circuit acknowledged that there were a "number of arguments" that ERISA did not apply to the contract at issue that the court had not previously considered and noted that they could be presented to the district court on remand. *Id.* at 328. *Cf. Associates in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 566-67 (7th

(Footnote continued)

through a Separate Account and those that provide for guaranteed benefits through the insurer's General Account. *Id.*

Moreover, the Third Circuit examined the legislative history of ERISA and found that it confirmed that section 1101(b)(2) was meant to address the inherent and intractable difficulties that would arise from imposing ERISA's fiduciary duties on the management of General Account assets. In contrast, neither the Seventh nor the Second Circuit gave any consideration to the consequences of applying those duties to General Account operations, and neither addressed the conflict between federal and state law that would inevitably result. Furthermore, neither court understood or gave sufficient weight to the DOL's consistent interpretation of the exception, first stated in Interpretive Bulletin 75-2, 29 C.F.R. § 2509.75-2 (1991) ("IB 75-2") (A-96), which was published in February 1975, shortly after ERISA's enactment.[9]

Because virtually all major insurance companies operate on a nationwide basis and have entered into group annuity contracts in all 50 states, the conflicting circuit court holdings confront insurers with enormous uncertainty regarding their obligations under existing contracts and in relation to the ongoing conduct of their pension-related General Account operations.

Cir. 1991) (insurance contract is a guaranteed benefit policy where insurer annually announced interest rate in advance and allowed the plan to withdraw its funds), *cert. denied*, 112 S. Ct. 1182 (1992).

[9] IB 75-2 was the DOL's first major interpretive pronouncement under ERISA. *See* 40 Fed. Reg. 31,598-99 (July 28, 1975).

II.

THE SECOND CIRCUIT DECISION CONTRADICTS 18 YEARS OF CONSISTENT REGULATORY INTERPRETATION OF THE STATUTE BY THE DEPARTMENT OF LABOR

The Second Circuit impermissibly substituted its own construction of ERISA for that of the DOL, the agency charged by Congress with its implementation. *See* 29 U.S.C. § 1135. In every instance when it has had occasion to address this issue, the DOL has consistently adhered to the view that, under the "guaranteed benefit policy" exception, funds held in insurance company General Accounts do not constitute "plan assets." That view was first stated in IB 75-2 (A-96):

> If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered plan assets.

Three years later, the DOL reiterated its interpretation that "assets held in an insurer's General Account to support benefits under a contract purchased by a plan are not plan assets . . . ." 44 Fed. Reg. 50,363, 50,364 n.4 (1979). Thereafter, the DOL continued to express that view.[10] In 1986, the DOL published

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[10] For example, in connection with the Proposed Regulation Relating to the Definition of Plan Assets, the DOL stated:

> With respect to most investments, the assets that a plan is considered to have acquired by reason of an investment are determined by reference to the terms of the instrument and applicable non-ERISA law. This general principle was first recognized by the Department in Interpretive Bulletin 75-2, which states that, generally, investment by a plan in securities of a corporation of [sic] partnership will not, solely by reason of such investment, be considered to be an investment in the underlying assets of such corporation or partnership so as to make such assets of the entity "plan assets."

(Footnote continued)

a final regulation dealing with the definition of "plan assets" in which it reaffirmed its consistently held view. *See Proposed Final Regulations Relating to the Definition of Plan Assets*, 51 Fed. Reg. 41,262 (Nov. 13, 1986) (A-105), codified in 29 C.F.R. § 2510.3-101 (A-99). The DOL has never expressed a contrary view in any of its public pronouncements, nor has it ever sought to compel insurers to comply with ERISA's fiduciary rules in connection with their General Account contracts or operations.

Ignoring the DOL's consistency in its interpretation and enforcement of the statute, the Second Circuit, without meaningful analysis, concluded that there was "confusion" in the DOL's published releases. Despite the overwhelming evidence of consistent interpretation, the court of appeals misconstrued and misapplied two DOL Advisory Opinions, Advisory Opinions 83-51A (September 21, 1983) and 78-8A (March 13, 1978), that, it said, were "seemingly contradictory" to IB 75-2 (A-11 to A-12).[11] In fact, those opinions did not relate at all to General Account contracts.[12] *Mack Boring*, 930 F.2d at 276 n.18.

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50 Fed. Reg. 961 (1985). *See also* 44 Fed. Reg. 46,365, 46,368 (1979); 45 Fed. Reg. 51,303, 51,304, 51,305 n.9 (1980); 46 Fed. Reg. 46,443, 46,444 (1981).

[11] The court of appeals compounded its error by interpreting IB 75-2 as dealing solely with prohibited transactions (A-11 to A-12). However, the DOL's references to IB 75-2 in subsequent pronouncements demonstrate that that release was intended to have broad applicability beyond the prohibited transaction context. *See Mack Boring*, 930 F.2d at 276.

[12] In Advisory Opinion 83-51A, the DOL determined that, under certain circumstances, the funds placed in a Separate Account would not be treated as "plan assets." In Advisory Opinion 78-8A, the DOL distinguished the fund at issue, which functioned like a Separate Account in that it provided variable annuity payments that were dependent upon the investment performance of the account, from a true insurance company General Account. The DOL therefore found that the account was a "Separate Account" and that the assets in the account were "plan assets." Accordingly, even a cursory review of these advisory opinions reveals that they address only Separate Account contracts, which are specifically defined in ERISA as holding "plan assets," and therefore do not in any way contradict IB 75-2. *See Mack Boring*, 930 F.2d at 276 n.18.

The permissible interpretation of a statute by the agency charged with its implementation should be given the highest degree of deference. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843, 844 (1984); *see also Rowan Companies, Inc. v. United States*, 452 U.S. 247, 251 (1981); *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944). The DOL has consistently expressed the view that General Account assets are not "plan assets," and the insurance industry has justifiably relied on that interpretation. The Second Circuit should have deferred to that permissible and correct construction.

III.

THE SECOND CIRCUIT DECISION IGNORES CONGRESS' ALLOCATION OF RESPONSIBILITY FOR REGULATING THE BUSINESS OF INSURANCE TO THE STATES

General Account investments and operations have long been subject to a plethora of state laws — laws that expressly regulate the insurance company practices challenged by Harris Trust as violations of ERISA.[13] For example, these laws limit the types of investments that can be made with General Account assets and require the diversification of investments and the maintenance of reserves. *E.g.*, N.Y. Ins. Law §§ 1402, 1403, 1409 (McKinney 1985); Mass. Gen. L. Ann. ch. 175 § 66B (West 1987 & Supp. 1992) (authorizing the use of General Account assets to invest in home office properties). Similarly, an insurer's allocation of income and expenses within its General Account is specifically regulated by state insurance departments, which, in Hancock's case, have endorsed its "investment year method" for distributing net investment income. *See* N.Y. Insurance

[13] In its motion for summary judgment in *Harris I*, Hancock identified the various state laws that governed Hancock's business practices alleged by Harris Trust to violate ERISA. In its opinion (A-31 n.10), the district court noted that: "Harris Trust concedes that each of the laws relates to employee benefit plans and that most of them probably regulate the business of insurance."

Department Regulation No. 33, N.Y. Comp. Codes R. & Regs. tit. 11, § 91.1 *et seq.* (1992). Furthermore, both the payment of dividends and the determination of the amount of divisible surplus available to be paid to an insurance company's policyholders have traditionally been matters subject to exclusive state regulation. *See, e.g.*, Mass. Gen. L. Ann. ch. 175 § 93E (West 1987).

At common law, an insurance company is not a fiduciary to its policyholders.[14] In contrast to ERISA's "solely in the interest of" standard, state insurance laws require that General Account assets be administered to spread risk fairly and equitably among all life, health, employee benefit and other contractholders whose contract rights are supported by such accounts. *E.g.*, N.Y. Ins. Law §§ 2403, 2606-08, 4239 (McKinney 1985); Conn. Gen. Stat. Ann. §§ 38a-815 to -816, 38a-446 to -447, -488 (West 1987 & Supp. 1991); Mass. Gen. L. Ann. ch. 176D, §§ 2-3, 3(7), ch. 175, § 120 (West 1991); N.J. Stat. Ann. §§ 17:29B-3 to -4, 17B:30-2 to -4 (West 1985). As the Third Circuit recognized in *Mack Boring*, these state law requirements are in conflict with ERISA's fiduciary standards:

> These state-imposed duties do not mesh easily with ERISA's requirement that plan assets be managed "solely in the interest" of plan customers. Whenever an insurance company acts "solely in the interest" of a pension plan customer, it would violate state law. Whenever an insurance company takes actions to ensure that under state law, it is treating its policyholders fairly and equitably, it runs the risk of violating ERISA's fiduciary requirements.

930 F.2d at 275 n.17.

[14] *See, e.g.*, *Benefit Trust Life Ins. Co. v. Union Nat'l Bank of Pittsburgh*, 776 F.2d 1174, 1177 (3d Cir. 1985); *Rochester Radiology Assocs. v. Aetna Life Ins. Co.*, 616 F. Supp. 985, 988 (W.D.N.Y. 1985); *Uhlman v. New York Life Ins. Co.*, 109 N.Y. 421, 429, 17 N.E. 363, 366 (1888).

This Court has noted on more than one occasion that, although ERISA is a comprehensive statute, it was not Congress' intent to displace in wholesale fashion separate regulatory systems established under state law. Indeed, in ERISA's preemption saving clause, 29 U.S.C. § 1144(b)(2)(A) (A-95), Congress expressed its specific intent that the regulation of the "business of insurance" be left to the States, as provided in the McCarran-Ferguson Act.[15] In the leading case of *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985), this Court settled that issue. The Court there held that a Massachusetts law was saved from preemption under 29 U.S.C. § 1144(a), because the law regulated "insurance" within the common-sense meaning of the term, and because the regulation of the "substantive terms" of insurance contracts fell squarely within the regulation of the "business of insurance" as defined by the Court in its earlier decisions. 471 U.S. at 746-48. As the Court explained:

> The ERISA saving clause, with its similarly worded protection of any law of any State which regulates insurance, appears to have been designed to preserve the McCarran-Ferguson Act's reservation of the business of insurance to the States. The saving clause and the McCarran-Ferguson Act serve the same federal policy and utilize similar language to define what is left to the States.

Id. at 744 n.21.

[15] The McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, provides, in pertinent part:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .

15 U.S.C. § 1012(a), (b). (A-93)

In *FMC Corp. v. Holliday*, 498 U.S. 52 (1990), the Court again addressed the relationship of ERISA to the McCarran-Ferguson Act's policy of reserving the regulation of insurance to the States. Applying the analysis in *Metropolitan Life*, the Court expressly found that, when a state insurance regulation collides with ERISA, ERISA must give way to state insurance regulation. In so holding, the Court was "respectful of the presumption that Congress does not intend to pre-empt areas of traditional state regulation" and of "Congress' presumed desire to reserve to the States the regulation of the 'business of insurance.'" *Id.* at 63 (citations omitted).

In *Mack Boring*, the Third Circuit properly construed the "guaranteed benefit policy" exception as preserving traditional state authority over General Account contracts and practices. As a consequence of the Second Circuit's decision, however, insurance company General Accounts, already regulated by the insurance commissioners in each of the States, would also be regulated under ERISA. If the Second Circuit's view prevails, insurance companies will not be able to operate their General Accounts in accordance with state law to the extent that ERISA's fiduciary provisions are deemed to apply.[16]

[16] There are numerous examples of conflicts with state law and the illogical and absurd results that necessarily will follow if the Second Circuit's decision is not reversed. For example, General Account funds are customarily and, under state insurance regulations, *see, e.g.*, Mass Gen. L. Ann. ch. 175, §§ 180A-180L (West 1987 & Supp. 1992); N.Y. Ins. Law §§ 7401-34 (McKinney 1985 & Supp. 1993), lawfully used to defray corporate expenses and to meet all General Account liabilities. However, under ERISA's fiduciary responsibility provisions, it is arguably unlawful for an insurance company to apply General Account funds to such non-employee benefit payment purposes as the payment of benefits under life insurance policies, the payment of salaries to insurance company employees, the payment of rent on insurance company office space. Such absurdities are inevitable, because the ERISA fiduciary duty rules are inherently inconsistent with the concepts of pooled assets and shared risk that are fundamental to the insurance relationship.

Some of the most striking examples of the potentially bizarre consequences of applying ERISA fiduciary duties in this context are seen in Harris Trust's own arguments in this case. For example, in the district court, Harris Trust

(Footnote continued)

Unless reversed, the decision of the court of appeals could have a serious impact upon the nation's capital markets. At year-end 1991, over 59 million persons were covered by private pension plans having contracts with life insurance companies. Total reserves held by life insurance companies under such contracts were over $746 billion. Of that total, approximately $565 billion, or 76%, were held in insurance company General Accounts under General Account contracts like the one at issue here. *See* American Council of Life Insurance, *1992 Life Insurance Fact Book* 54-59 (1992).

The Second Circuit decision has cast doubt on the legality of existing General Account contracts and practices and exposed the industry to a potential flood of litigation. It has created substantial uncertainty, despite the absence of any indication of a Congressional intent to impose fiduciary duties on insurers' General Account practices and the consistent interpretation of the legislation by the DOL. As the Third Circuit noted in *Mack Boring*:

> [I]f Congress had intended so severe a disruption of insurance practices, practices that had been in existence for almost three decades before the enactment of ERISA, it would have made its intention perfectly clear. After all, ERISA was expressly "designed to prevent a fiduciary 'from being put in a position where he has dual loyalties, and therefore, he cannot act exclusively for the benefit of a plan's participants and

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asserted that it is *per se* unlawful for an insurance company to place premiums received under a group annuity contract in its General Account — even though the contract expressly requires it — because under ERISA that constitutes unlawful commingling. The obligations Harris Trust would impose are entirely at odds with the essential nature of a General Account contract. If ERISA's fiduciary duty rules apply, then any insurance company conduct, though expressly permitted (or even required) under the terms of a group annuity contract, could nonetheless constitute an actionable breach of fiduciary duty if that conduct were found to disadvantage any particular pension plan contractholder in some way.

> beneficiaries.'" . . . There is no such clear indication in the legislative history of the guaranteed benefit policy exception. Indeed, the legislative history . . . points in the opposite direction.

930 F.2d at 275 n.17 (citation omitted).

IV.

THE SECOND CIRCUIT'S CONSTRUCTION OF ERISA'S "GUARANTEED BENEFIT POLICY" EXCEPTION IS ERRONEOUS

As construed by the Third Circuit, the "guaranteed benefit policy" exception exempts from fiduciary status all General Account group annuity contracts that "provide for" fixed guaranteed benefit payments. *Mack Boring*, 930 F.2d at 274. The Third Circuit interpreted the "to the extent that" language of the exception as distinguishing contracts that provide for the payment of fixed guaranteed benefits from contracts that have a Separate Account feature and provide in whole or in part for variable benefits (*i.e.*, benefits the amount of which varies depending upon the investment performance of the underlying assets). It reached that conclusion by giving effect to the second sentence of the exception, which states that assets held in Separate Accounts are "plan assets."

The Second Circuit, like the Seventh Circuit in *Peoria Union*, misread the "guaranteed benefit policy" exception. It incorrectly construed the exception to turn not only on whether benefit payments to participants are fixed, rather than variable, but also on whether a contract provides for a fixed, rather than variable, rate of return (about which the statute says nothing):

> Although Hancock provides guarantees with respect to one portion of the benefits derived from the contract, it does not do so at all times with respect to all

> the benefits derived from the other, or free funds, portion. The non-guaranteed portion is dependent upon the insurer's investment experience and *therefore is variable with respect to the benefits it provides.*

(A-10 to A-13) (emphasis added). While the amount of the "free funds" under the contract will undoubtedly vary with the General Account's investment performance, that is also true of the funds supporting the contract as a whole. It is undisputed, however, that benefit payments to participants under GAC 50 are fixed in amount and do not vary.

Because of the Second Circuit's failure to apprehend the distinction between variable investment performance and variable benefit payments, it completely misread the only specific reference in the legislative history to the "guaranteed benefit policy" exception:

> If the policy guarantees basic payments but other payments may vary with, *e.g.*, investment performance, then the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.

H.R. Rep. No. 1280, 93d Cong., 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5077 ("Conference Report"). It is plain that the distinction drawn by the exception is between fixed and variable benefit payments, not between fixed and variable return on investment, and that Congress' intention was to treat as "plan assets" only those assets held by insurance companies that support variable benefits (*i.e.*, assets typically held in insurance company Separate Accounts).

ERISA's legislative history clearly supports the construction of the exception adopted by the Third Circuit. The versions of ERISA passed by both the House and Senate speak in terms of a blanket exception for insurance company General Account assets, not a partial exception. The Senate bill expressly exempted General Account assets from its fiduciary provisions:

> (k) This section governing fiduciary responsibilities shall not apply to—
>
> (1) funds held by an insurance carrier unless that carrier holds funds in a separate account. . . .

S.4, 93d Cong., 1st Sess. § 511 (1973), *reprinted in* I Legislative History of ERISA at 170 (Comm. Print 1976). Although the final House bill did not contain the same language, the House bill embodied the same policy and contemplated the same result. The Senate Staff's Summary of Differences, comparing the Senate and House bills, stated: "Although the House bill does not specifically exempt these funds from the fiduciary responsibility rules, the policy of the House bill is the same."[17] There is nothing in the Conference Report to suggest that the legislation was intended to reverse that policy.[18]

Nowhere in ERISA's legislative history is there any statement by Congress that it intended ERISA's fiduciary rules to apply to insurance company General Accounts or that it intended to re-write or supplant the longstanding framework of state insurance regulation. *Mack Boring*, 930 F.2d at 275 n.17. It is not surprising, therefore, that the Second Circuit, in its analysis, did not cite to any legislative history indicating that Congress considered, or was even aware of, the possible drastic consequences to the insurance industry of applying ERISA's fiduciary rules to the billions of dollars held by insurance companies in

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[17] Summary of Differences Between the Senate Version of H.R. 2, pt. 3, 94th Cong., 2d Sess. at 2, 3 (1974), *reprinted in* 3 Staff of Senate Comm. on Labor and Public Welfare, 94th Cong., 2d Sess., Legislative History of ERISA at 5252 (Comm. Print 1976).

[18] Both the Standing Rules of the Senate and the Rules of the House of Representatives provide that a joint Senate and House conference committee is prohibited from striking provisions that have been agreed upon by both chambers. Standing Rules of the Senate, Rule XXVIII, §2; Rules of the House of Representatives, Rule XXVIII, §3. Thus, the legislation as enacted must be construed to incorporate both chambers' intent.

their General Accounts. If Congress had intended to change the existing scheme of state regulation, those changes would surely have been discussed at some stage of the legislative deliberations. *Id.* ("we do believe that if Congress had intended so severe a disruption of insurance practices . . . it would have made its intention perfectly clear"). The complete absence of any such discussion is itself eloquent testimony that no such change was intended. *See Mead Corp. v. Tilley*, 490 U.S. 714, 723 (1989); *Watt v. Alaska*, 451 U.S. 259, 271 n.3 (1981).

Conclusion

For all the above-stated reasons, the Court should issue a writ of certiorari as prayed for herein to review the judgment of the United States Court of Appeals for the Second Circuit.

December 22, 1992

Respectfully submitted,

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APPENDIX

Opinion of the Court of Appeals

***Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*,**
970 F.2d 1138 (2d Cir. 1992)

HARRIS TRUST AND SAVINGS BANK,
as Trustee for the Sperry Master Retirement
Trust #2, Plaintiff-Appellant,

v.

JOHN HANCOCK MUTUAL LIFE INSURANCE CO.,
Defendant-Appellee.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,
Third-Party Plaintiff,

v.

CHASE MANHATTAN BANK, N.A.,
Counterclaim-Defendant,

and

Sperry Corporation and the Retirement Committee of Sperry Corporation, Third-Party Defendants.

No. 979, Docket 91-7854.

United States Court of Appeals, Second Circuit.

Argued Feb. 11, 1992.

Decided July 30, 1992.

Before: FEINBERG, TIMBERS and MINER, Circuit Judges.

MINER, Circuit Judge:

Plaintiff-appellant Harris Trust and Savings Bank as Trustee for the Sperry Master Retirement Trust No. 2 and its successor, the Unisys Master Trust ("Harris Trust"), appeals from a final judgment entered on August 16, 1991 in the United States District Court for the Southern District of New York (Patterson,

J.) in favor of defendant-appellee John Hancock Mutual Life Insurance Company ("Hancock"). The final judgment dismissed in its entirety the amended complaint in this action in accordance with two opinion-orders, the first granting partial summary judgment dismissing Harris Trust's claim for breach of fiduciary duties under the Employee Retirement Income Security Act of 1947 ("ERISA"), 29 U.S.C. § 1001 *et seq.*, and the second granting summary judgment dismissing Harris Trust's contract and common law claims. *See Harris Trust & Savings Bank, as Trustee of the Sperry Master Retirement Trust No. 2 v. John Hancock Mutual Life Ins. Co.*, 722 F.Supp. 998 (S.D.N.Y.1989) ("*Harris I*") and *Harris Trust & Savings Bank, as Trustee of the Sperry Master Retirement Trust No. 2 v. John Hancock Mutual Life Ins. Co.*, 767 F.Supp. 1269 (S.D.N.Y.1991) ("*Harris II*").

The dispute between the parties centers upon a certain contract known as Group Annuity Contract No. 50 ("GAC 50"), originally entered into in 1941 between Hancock and Sperry Rand Corporation to fund a retirement plan for the benefit of Sperry employees. Sperry has undergone a number of changes in name and corporate form since the execution of GAC 50 but will be referred to herein by its original name. Harris Trust is the present trustee of the retirement plan and the ultimate successor to Sperry's right as contractholder of GAC 50. In *Harris I*, the district court decided that Hancock was exempt from the fiduciary responsibility provisions of ERISA in connection with the management of GAC 50 for the reason that GAC 50 is a "guaranteed benefit policy." In *Harris II*, the district court decided that there was no basis for any of the contractual and other common law claims pleaded by Harris Trust against Hancock. The sole challenge to *Harris II* raised by Harris Trust on this appeal relates to the district court's rejection of the claim that Hancock breached GAC 50 by terminating the payment of non-guaranteed pension benefits. As to the ERISA fiduciary claims disposed of in *Harris I*, Harris Trust argues here, as it did in the district court, that Hancock is an ERISA fiduciary with respect to the assets it holds under GAC 50; that Hancock is an ERISA fiduciary in respect of the contract itself; and that Hancock is in any event collaterally estopped from re-litigating

the fiduciary status issue as the consequence of an order in another case, subsequently vacated, deciding the very question presented here.

To assist us in resolving the issue of fiduciary responsibility, we solicited an *amicus* brief from the United States Department of Labor, the government agency charged with the enforcement of ERISA. The Department apparently has issued an Interpretive Bulletin, as well as two Advisory Opinions, bearing on the issue. The Bulletin is not entirely clear and appears to be in conflict with the Opinions. Following oral argument, the Clerk of the Court, at our direction, invited the submission of an *amicus* brief within thirty days of receipt of her letter dated February 12, 1992. By motion dated March 3, 1992, the Department of Labor sought an extension to May 12, 1992, asserting that the additional time (approximately three months) was needed because (1) the Secretary had not formulated a final position on the issue; (2) the case was important and complex; (3) more time was needed for an examination of legislative and regulatory history; (4) a review of the record was required; and (5) approval of the Department of Justice was required. Recognized in the moving papers was the split in circuit court authority on the issue and the Secretary's interest in promoting uniformity. We granted the requested extension.

By letter dated May 11, 1992 from Marshall J. Breger, Solicitor of Labor, we were advised as follows:

> During the time allotted by the Court, we have undertaken an extensive review of the legal and policy issues involved in this matter. Regrettably, we have concluded that the need to fully consider all of the implications of these issues within the Department precludes our providing the Court with a brief within a foreseeable time frame. Accordingly, rather than seek a further extension, I feel constrained to decline the Court's invitation.

We do not understand why the Solicitor of Labor is unable to provide an *amicus* brief "within a foreseeable time frame" and can only deplore his failure to do so in this case. While it is not unusual for a government agency to decline an invitation to file an *amicus* brief on account of bureaucratic inertia or inability to articulate a coherent policy, *see Popkin v. Bishop*, 464 F.2d 714, 719 n. 15 (2d Cir.1972); *Securities Industry Ass'n v. Connolly*, 703 F.Supp. 146, 155 n. 16 (D.Mass.1988), *aff'd*, 883 F.2d 1114 (1st Cir.1989), *cert. denied*, 495 U.S. 956, 110 S.Ct. 2559, 109 L.Ed.2d 742 (1990), it is unconscionable for an agency to request a substantial extension of time and then fail to file the promised brief. It is especially egregious to request an extension as long as that requested here and then to advise in effect that no extension would be long enough. Courts do not have the luxury of deferring decisions indefinitely, however, and we proceed to dispose of the matter before us. We reverse in part on the fiduciary duty issue and affirm on the contract termination issue.

BACKGROUND

As originally constituted on March 1, 1941, GAC 50 provided for the purchase of individual deferred annuities from Hancock for the Sperry Defined Benefit Retirement Plan. These annuities were purchased on an annual basis for each employee with premiums, or contributions, paid to Hancock by Sperry. They provided for regular payments to eligible Sperry employees or their beneficiaries following retirement. The premiums became part of Hancock's general account of corporate funds, and Hancock issued the guaranteed annuities at purchase rates fixed by the contract.

By amendment effective January 1, 1968, GAC 50 was converted from a deferred annuity form of contract to a Retrospective Immediate Participation Guarantee ("Retro-IPG") form of contract. The deferred annuities purchased prior to January 1, 1968 were technically cancelled and the assets supporting them placed in a Pension Administration Fund ("PAF"). However, the cancellation of the pre-1968 annuities did not affect the

guarantees of benefits by Hancock to the participants and beneficiaries. With respect to the Retro-IPG, net investment income was directly credited to the PAF on an annual basis. The amount credited depended upon Hancock's general account investment performance and the allocation of that performance to the PAF. Under the 1968 amendment, Hancock guaranteed that once an employee's retirement annuity has been established, Hancock is obligated to make all future payments due under the annuity. Hancock also guaranteed that the PAF on any date would not be less than it otherwise would have been if the sum of the net interest earned and capital gains and losses apportioned to the PAF had always been zero from January 1, 1968. (Hancock in effect guaranteed that the PAF would never fall below its January 1, 1968 level.) As in the case of the deferred annuity form of contract, the premiums paid under the Retro-IPG contract became part of Hancock's general corporate funds.

The 1968 amendment required that the PAF be maintained at a level sufficient to meet the Liabilities of the Fund ("LOF") as computed by Hancock. LOF is the contractual reserve for the possible future purchase of annuities for the benefit obligations guaranteed by Hancock. The specific requirement was that the PAF balance be maintained at a level at least 105 per cent of LOF. The amount in the PAF in excess of this minimum operating level ("MOL") has been referred to by the parties as "free funds." If Sperry failed to maintain Fund balances at or above MOL, termination of the PAF would be triggered. Upon termination, the contract would cease to function in the manner of a Retro-IPG, the cancelled pre-1968 annuities would be "repurchased" and the contract would function thereafter in the manner of a deferred annuity contract. For more than 20 years, the PAF balance in GAC 50 has exceeded its MOL. The 1968 amendment also established a method for the provision of additional benefits for the period after December 31, 1967: upon the retirement of an eligible employee, Hancock would determine the amount by which the LOF would increase if the portion of the retirement benefit in the period after January 1, 1968 were to be "guaranteed" by Hancock. If GAC 50's PAF balance exceeded the contractual MOL based upon the increased LOF,

Hancock would guarantee the payment of the additional benefits.

On August 1, 1977, GAC 50 again was amended. This amendment involved its conversion to a Retrospective Immediate Participation Guarantee/Prospective Deferred Liability ("Retro-IPG-PDL") form of contract. Under the amendment, the LOF would not automatically be increased upon the retirement of any employee, and new retirement benefits would not be guaranteed by Hancock. The Sperry retirement committee could request that Hancock establish guaranteed benefits in addition to those already guaranteed, but did not do so. Sperry was entitled to designate employees eligible for non-guaranteed benefits and did designate employees to receive such benefits from the free funds in the PAF. Hancock paid such benefits on a monthly basis through June of 1982, when it gave notice as provided in the contract that it would no longer pay non-guaranteed benefits under the Retro-IPG-PDL.

Contending that Hancock's elimination of the non-guaranteed benefit payments and its elimination of the "rollover" procedure (under which withdrawals of excess funds from the PAF were allowed on two occasions) left it with no means of withdrawing any of the increasing free funds without terminating the contract and causing the purchase of annuities at inflated prices, Harris Trust commenced this action on July 20, 1983. It was the Trustee's position that Hancock employed an artificially low interest assumption to calculate the LOF, resulting in: the setting of LOF at a level much higher than necessary to provide the benefits guaranteed under the contract, oversecuring Hancock and preventing termination; and a geometrically increasing level of free funds in the PAF.

Because it allegedly was denied access to the accumulating free funds over a substantial period of time, and because Hancock was said to have administered GAC 50 improperly, Harris Trust sought in the amended complaint in this action to recover the non-guaranteed benefits withheld by Hancock, the losses resulting from Hancock's breach of duties, the profits made by

Hancock using Sperry funds, and damages in an amount to be determined at trial. The complaint also sought the removal of Hancock as fiduciary, judgment enjoining Hancock from further violations of its duties, and other relief. Hancock pleaded counterclaims against Harris Trust and interposed a third-party complaint against Sperry, demanding judgment over in the event that it was found liable to Harris Trust for the breach of any common law or fiduciary duty. As previously described, the district court granted summary judgment in *Harris I* dismissing the ERISA fiduciary claims and in *Harris II* dismissing the contractual and other common law claims. The counterclaims and third-party complaint thereafter were dismissed as moot.

DISCUSSION

I. ERISA Fiduciary Status

(a) *As to Assets in General Account*

Harris Trust claims that Hancock bears fiduciary responsibilities to the Plan and its participants as to the free funds in the PAF under the provisions of ERISA. As defined in ERISA, one is

> a fiduciary with respect to a plan to the extent . . . he exercises any discretionary authority or discretionary control respecting management . . . or disposition of its assets . . .

29 U.S.C. § 1002(21)(A). An insurance company holding a certain type of pension fund asset in its general account escapes the definition and the concomitant duties of a fiduciary in accordance with the following provision:

> In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer.

29 U.S.C. § 1101(b)(2). A guaranteed benefit policy is

> an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer.

29 U.S.C. § 1101(b)(2)(B).

It seems clear that, at least to the extent it provides for benefits guaranteed by Hancock, GAC 50 is a guaranteed benefit policy and Hancock does not act as a fiduciary in administering it. The question is: Do the free funds, as to which no guarantees are available, affect the status of GAC 50 as a guaranteed benefit policy excepted from the definition of plan assets? The district court answered that question in the negative:

> Each time ERISA uses the word 'benefit,' it refers to the payments made to the employees themselves. *See, e.g.*, 29 U.S.C. § 1002(7) ('"participant" means any employee . . . who is or may become eligible to receive a benefit of any type from an employee benefit plan'); *id* § 1002(8) (' "beneficiary" means a person designated by a participant . . . who is or may become entitled to a benefit'); *id.* §§ 1023(e), 1054, 1056, 1104(a)(1)(A)(i), 1108(c)(1). The word 'benefit' in the guaranteed benefit policy exception . . . refer[s] to benefits and payments to covered employees. Because GAC 50 provides for fixed payments to covered employees, it is covered by the guaranteed benefit policy exception.

Harris I, 722 F.Supp. at 1017-18.

We think that the district court erred in concluding that GAC 50 in its entirety is covered by the guaranteed benefit policy exception. In the plain language of the statute, a contract is a guaranteed benefit policy only "to the extent that" it provides for benefits that an insurer guarantees. Although Hancock provides guarantees with respect to one portion of the benefits

derived from the contract, it does not do so at all times with respect to all the benefits derived from the other, or free funds, portion. The non-guaranteed portion is dependent upon the insurer's investment experience and therefore is variable with respect to the benefits it provides. Legislative history supports the view that the free funds held in the GAC 50 PAF are plan assets and not included within the guaranteed policy exception:

> If the policy guarantees basic payments but other payments may vary with, e.g., investment performance, then the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.

H.R.Rep. No. 93-1280, 93rd Cong., 2d Sess. (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5077 ("Conference Report").

When confronted with a situation similar to the one before us, the Seventh Circuit recognized that group annuity contracts such as GAC 50 can be analyzed in terms of their guaranteed and non-guaranteed elements. The Seventh Circuit held in *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Ins. Co.*, 698 F.2d 320 (7th Cir.1983) that the contract in that case was not a guaranteed benefit policy in its variable accumulation phase because the amount of funds available to the pension plan was determined by the manner in which the insurer exercised its investment discretion:

> The pension trustees did not buy an insurance contract with a fixed payout; they turned over the assets of the pension plan to [the insurance company] to manage with full investment discretion, subject only to a modest income guaranty. If the pension plan had hired an investment advisor and given him authority to buy and sell securities at his discretion for the plan's account, the advisor would be a fiduciary within the meaning of the act, and that is essentially what the trustees did during the accumulation phase of the contract. . . .

Id. at 327.

Similarly, in the case before us the insurer has maintained funds that were not converted to fixed, guaranteed obligations but instead were subject to fluctuation based on the insurer's investment performance. But the statute defining "guaranteed benefit policy," as noted previously, refers only to that phase of the contract in which the insurer is obligated to guarantee fixed benefits to plan participants. To the extent that the insurer engages in the discretionary management of assets attributable to that phase of the contract which provides no guarantee of benefit payments or fixed rates of return, it seems to us that the insurer should be subject to fiduciary responsibility. *See* 29 U.S.C. § 1002(21)(A).

The district court of course disagreed with the reasoning of *Peoria Union*, holding that retirement plan assets such as GAC 50 do not include funds held in an insurer's general account. In support of its conclusion, the district court reasoned that the

> amount provided to the covered employees remains fixed even if the PAF falls below the minimum operting level and the contract reverts to a deferred annuity type .... [I]f Hancock's general account experiences negative investment results, it must still pay the covered employees the amounts to which they are entitled .... Hancock could request additional contributions from Harris Trust, but Harris Trust would be free to decline. GAC 50 would then revert to deferred annuity form, and Hancock would be obliged to provide annuities to all covered employees in consideration of the benefits guaranteed to those employees up to that time.

Harris I, 722 F.Supp. at 1016-17.

The flaw in this reasoning lies in the fact that at certain times, until there is a conversion to guaranteed benefits, Hancock is managing assets taken in under GAC 50 as to which there are no guarantees. The fact that all the assets of GAC 50 are held in Hancock's general account is not significant in view of

Hancock's discretionary authority over the non-guaranteed phase of the contract. In *Mack Boring and Parts v. Meeker Sharkey Moffitt*, 930 F.2d 267 (3d Cir.1991), the Third Circuit adopted the district court's approach in a case involving a contract with attributes similar to those of GAC 50. The Third Circuit held that the contract was, in its entirety, a guaranteed benefit policy because it was a "general account insurance contract in which the issuing insurance company guarantees to the plan participants a fixed amount of benefits, payable at a clearly stated time." *Id.* at 277. It was sufficient for the *Mack Boring* court that the contract made provision for "guaranteed benefits to plan participants at some finite point in the future." *Id.* at 273. That court in effect extended the statutory exemption to the entirety of any contract under which any benefits are guaranteed, so that the exemption would apply regardless of the apportionment between the guaranteed component and the investment component of the contract.

Two Advisory Opinions issued by the Department of Labor lend support to the notion that the free funds in GAC 50 are plan assets as to which Hancock is an ERISA fiduciary. In the first, reference is made to

> a Congressional intent that when an insurance company provides investment advice which determines the rate of return to the plan and its participants, the assets in the account shall constitute plan assets so that the insurance company is subject to the fiduciary responsibility provisions of the Act.

DOL Advisory Opinion 78-8A (March 13, 1978). As to at least one component of GAC 50, Hancock's investment performance clearly does affect the amount of funds available to the plan and its participants.

According to the second DOL Advisory Opinion,

> a conventional separate account (which holds contributions received from a plan and provides for the

> crediting of income on such amounts based upon the investment experience of the separate account) would not be considered to be maintained in connection with a fixed contractual obligation of the insurance company merely because assets of the separate account are ultimately applied to provide fixed annuities to participants, and the assets of such a separate account would be considered to be plan assets.

DOL Advisory Opinion 83-51A (September 21, 1983). The Department of Labor in the second opinion thus appears to take the position that "plan assets" for the purpose of the fiduciary responsibility provisions of ERISA do not lose their status as such merely because the ultimate use of the account may be to provide fixed annuities, where the plan assets are affected by investment performance.

Both advisory opinions were preceded by a seemingly contradictory Department of Labor pronouncement, Interpretive Bulletin 75-2:

> If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets. Therefore, a subsequent transaction involving the general asset account between a party in interest and the insurance company will not, solely because the plan has been issued such a contract or policy of insurance, be a prohibited transaction.

This Interpretive Bulletin was confirmed in a regulation adopted November 13, 1986. *See* 29 C.F.R. § 2509.75-2 entitled "Interpretive bulletin relating to prohibited transactions." Despite the confusion, it seems to us that the Interpretive Bulletin was designed to deal with prohibited transactions in regard to

conflict of interest situations. Indeed, the preamble to the regulation recites that IB 75-2 was issued

> with respect to whether a party in interest has engaged in a prohibited transaction with . . . a corporation or partnership . . . in which the plan has invested.

There is no inconsistency in considering certain assets to be plan assets for general fiduciary duty purposes but not for prohibited transaction purposes. *See Associates in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 729 F.Supp. 1162, 1184-85 (N.D.Ill.1989), *aff'd*, 941 F.2d 561 (7th Cir. 1991), *cert. denied*, ____U.S.____, 112 S.Ct. 1182, 117 L.Ed.2d 426 (1992).

(b) *As to the GAC 50 Contract*

We agree with the district court that the contract itself, GAC 50, is not a plan asset as to which Hancock has a fiduciary responsibility. According to the statute, the assets of a plan to which an insurer issues a guaranteed benefit policy "shall be deemed to include such policy." 29 U.S.C. § 1101(b)(2). The policy itself, with its bundle of contractual rights and responsibilities, therefore is similar to any other financial instrument owned by an employee benefit plan. Hancock is not a fiduciary in regard to the policy here, however, because it does not "exercise[ ] any discretionary authority or discretionary control . . . respecting management or disposition of" the policy itself. 29 U.S.C. § 1002(21)(A). Only Harris Trust as contractholder has discretionary authority over the guaranteed benefit policy *qua* policy.

The view that the holder of the contract is the entity subject to fiduciary responsibility is supported by legislative history:

> A trust is not to be required in the case of plan assets which consist of insurance (including annuity) contracts or policies issued by an insurance company qualified to do business in a State (or the District of Columbia) . . . . Although these contracts need not be

> held in trust, nevertheless, the person who holds the contract is to be a fiduciary and is to act in accordance with the fiduciary rules . . . with respect to these contracts.

Conference Report, *supra*, at 5079.

Obviously, Hancock has no power unilaterally to alter or amend a contract to which it is a party. It can act only under the terms of the policy, and any change in the policy requires the consent of the contractholder. We here deal with the policy in its entirety, and any power that Hancock had was referable to the terms of that policy. While Hancock may act as a fiduciary in carrying out certain of its contractual duties under the policy as previously described, it has no fiduciary responsibility in regard to the undivided contract. Neither of the cases that Harris Trust relies upon to support the argument that Hancock will be held to fiduciary standards with respect to the contract itself is apposite. In both *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 737-38 (7th Cir.1986), *cert. denied*, 482 U.S. 915, 107 S.Ct. 3188, 96 L.Ed.2d 676 (1987), and *Chicago Bd. Options Exchange, Inc. v. Connecticut General Life Ins. Co.*, 713 F.2d 254 (7th Cir.1983), the insurer had and exercised a unilateral right to alter in its discretion a critical contract term, resulting in prejudice to the contractholder. Such was not the case here, where Hancock at all times exercised its express rights under the contract. Fiduciary duties were implicated only when Hancock became involved in the administration or management of plan assets not referable to guaranteed benefits. *See Amato v. Western Union Int'l, Inc.*, 773 F.2d 1402, 1416-17 (2d Cir.1985); *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1159-60 (3d Cir.1990).

(c) *As Affected By Prior Litigation*

In *Jacobson v. John Hancock Mutual Life Ins. Co.*, 655 F.Supp. 1290, *withdrawn pursuant to settlement*, 662 F.Supp. 1103 (D.Conn.1987), the plaintiff pension plan trustees asserted that Hancock was a fiduciary with respect to a Retro-IPG

contract, similar to GAC 50, and the funds held under the contract. The *Jacobson* court granted partial summary judgment, holding that funds received by Hancock, not converted to fixed guaranteed obligations but held subject to fluctuations based on investment performance, were "plan assets" for which the insurer was accountable as an ERISA fiduciary. Hancock thereafter settled with the trustees, and the opinion was withdrawn pursuant to the settlement. Harris Trust argues that Hancock is estopped from relitigating the issue of its status as an ERISA fiduciary by the vacated district court order.

The district court properly rejected the argument of Harris Trust that Hancock is collaterally estopped from relitigating its fiduciary status as to Retro-IPG contracts by virtue of the district court's decision in *Jacobson*. The order entered on the stipulation of the parties in that case included the following language:

> ORDERED, that the Order, together with the findings and conclusions embodied therein, is withdrawn, set aside and vacated, and shall be of no force or effect for use against defendant, its successors and assigns, by plaintiffs, by the Pension Fund or by third parties, for collateral estoppel or other preclusive purposes. . . .

Jacobson, 662 F.Supp. at 1113. It is well-settled in this circuit that a vacated order has no collateral estoppel effect. *See Corporation of Lloyd's v. Lloyd's U.S.*, 831 F.2d 33, 36 (2d Cir.1987); *Universal City Studios, Inc. v. Nintendo Co.*, 578 F.Supp. 911, 919-20 (S.D.N.Y.1983), *aff'd*, 746 F.2d 112 (2d Cir.1984). We have held that it is an abuse of discretion for a district court to refuse to enter a vacatur pursuant to a settlement providing that the vacated order would not have collateral estoppel effect in any subsequent action. *Nestle Co. v. Chester's Mkt., Inc.*, 756 F.2d 280, 282 (2d Cir. 1985). We recognized in *Nestle* "the importance of honoring settlements over the finality of trial court judgments." *Id.* at 283. The district court correctly refused to estop Hancock from litigating its fiduciary status on the basis of *Jacobson*.

II. *Contract Termination*

Harris Trust contends that Hancock breached GAC 50 by terminating non-guaranteed benefit payments. We reject that contention and agree with the district court that Hancock properly terminated these benefits on 31 days notice. Hancock properly relied upon the following contractual provision as conferring the right to terminate:

Section 9. Payment of Non-guaranteed Benefits.

> Non-guaranteed Benefit payments shall be payable to a payee, provided the Pension Administration Fund is sufficient for the purpose, upon written notice from the [employer] to the [insurer].... Non-guaranteed Benefit payments shall continue until
>
> * * * * * *
>
> (c) the date as of which the [insurer], by written notice filed with the Retirement Committee at least thirty-one days prior thereto, declares its intention to cease such payments.

GAC 50, 1977 Amendment, Article 4, Section 9.

It is the position of Harris Trust that Hancock has the right to terminate non-guaranteed benefit payments only if the PAF is insufficient to allow for such payments. That position is predicated principally on two provisions in the contract:

> On and after the Benefit Commencement Date of an employee, the Non-guaranteed Benefit for such an employee or his designated survivor shall be payable hereunder in accordance with the Plan until the earliest of the date of his death, the date the Retirement Committee notifies the Company in accordance with Section 9 of Article IV that said Non-guaranteed Benefit payments are to be cancelled, suspended or adjusted, or the date the Pension Administration Fund is not sufficient to provide the Non-guaranteed Benefits for the payee.

GAC 50, 1977 Amendment, Article II, Section 3.

> On the Benefit Commencement Date of an employee and on each date thereafter on which a Non-guaranteed Benefit is due with respect to an employee on or before the date of termination of the Fund, a Non-guaranteed Benefit shall be provided hereunder with respect to each employee entitled thereto. The Company shall be liable for any amount of Non-guaranteed Benefit expressed to be payable only to the extent to which the Fund is sufficient to provide such amount.

GAC 50, 1977 Amendment, Article III, Section 2(b).

Contrary to the reading of Harris Trust, the contract does not prohibit termination before the PAF becomes insufficient. The Article III provision is entitled "Contributions" and in the main deals with the methods of contributions to the plan. The quoted language makes the unexceptional statement that non-guaranteed benefits are available only to the extent permitted by the PAF. The Article II provision is entitled "Dates of Coverage and Plan of Benefits" and deals specifically with those matters covered by that title. To say as that provision does that non-guaranteed benefits shall be payable until the date of death, notification by the Retirement Committee or the date the PAF is insufficient is not to gainsay the later provision of Article IV for termination on the basis of another contingency, i.e., thirty-one days notice. It is significant that Article IV follows the provisions upon which Harris Trust relies and, as amended, is entitled "Provisions Pertaining to the Payment of Benefits." It also is significant that Section 9 of Article IV is entitled "Payment of Non-Guaranteed Benefits," repeats the grounds for termination previously recited and adds one besides—termination on

notice. Important, if not controlling for our purposes, is the fact that all the grounds for termination provided in Section 9 are accorded equal dignity by being listed separately.

Although the district court took some testimony pursuant to Fed.R.Civ.P. 43(e) to determine whether there was an issue of fact in connection with the motion for summary judgment, it ultimately determined that

> the alleged conflict in language between Article IV, Section 9, and Article II, Section 3, relied on by plaintiff is resolved by the underlying structure of the contract itself, as to which there is no genuine issue of material fact . . . . Accordingly, Hancock's termination of non-guaranteed benefits in 1982 did not constitute a breach of contract.

Harris II, 767 F.Supp. at 1278. We endorse the conclusion of the district court. Where the language of a contract is clear, summary judgment is appropriate, and the fact that one party may have a different interpretation of the language does not make it any less plain. *See Investors Ins. Co. v. Dorinco Reins. Co.*, 917 F.2d 100, 104 (2d Cir.1990). The proper interpretation of a contract is a question of law for the court. *See Hunt Ltd. v. Lifschultz Fast Freight, Inc.*, 889 F.2d 1274, 1277 (2d Cir.1989). Extrinsic evidence is unnecessary where it is determined that the contractual language is unambiguous. *See Chimart Assocs. v. Paul*, 66 N.Y.2d 570, 573, 498 N.Y.S.2d 344, 346, 489 N.E.2d 231, 233 (1986). The district court properly limited itself to the unambiguous contractual language in resolving the issue of termination in this case.

CONCLUSION

The judgment of the district court is reversed to the extent that it determined that Hancock had no fiduciary duty with regard to the excess funds allocated to the payment of non-guaranteed benefits and affirmed in all other respects. The case is remanded for further proceedings consistent herewith.

Judgment of the Court of Appeals

Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.,
No. 91-7854 (2d Cir. July 30, 1992)

United States Court of Appeals
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 30th day of July, one thousand nine hundred and ninety-two.

Present: HON. WILFRED FEINBERG,
HON. WILLIAM H. TIMBERS,
HON. ROGER J. MINER,

Circuit Judges.

HARRIS TRUST AND SAVINGS BANK, as Trustee for the Sperry Master Retirement Trust #2,

Plaintiff-Appellant,

— against —

Docket No. 91-7854

JOHN HANCOCK MUTUAL LIFE INSURANCE CO.,

Defendant-Appellee.

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JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Third-Party Plaintiff,

— against —

CHASE MANHATTAN, N.A.,

Counterclaim-Defendant,

and

SPERRY CORPORATION and THE RETIREMENT COMMITTEE OF SPERRY CORPORATION,

Third-Party Defendants.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of said district court be and it hereby is affirmed in part, reversed in part and remanded to the said district court for further proceedings in accordance with the opinion of this court.

ELAINE B. GOLDSMITH, Clerk
By:

/s/Edward J. Guardaro
Edward J. Guardaro,
Staff Attorney

Opinion and Order of the District Court
September 26, 1989

Harris Trust & Sav. Bank v.
John Hancock Mut. Life Ins. Co.,
722 F. Supp. 998 (S.D.N.Y. 1989)

HARRIS TRUST & SAVINGS BANK, as Trustee of the Sperry Rand Master Retirement Trust No. 2 (and its successor, the Unisys Master Trust), Plaintiff,

v.

JOHN HANCOCK MUTUAL LIFE INSURANCE CO., Defendant.

No. 83 Civ. 5401(RPP).

United States District Court,
S.D. New York.

Sept. 26, 1989.

OPINION AND ORDER

ROBERT P. PATTERSON, Jr.,
District Judge.

Harris Trust and Savings Bank, trustee of the Sperry Rand Master Retirement Trust No. 2, has sued John Hancock Mutual Life Insurance Company, alleging breaches of contract, breaches of fiduciary duty, professional malpractice, unjust enrichment, and assorted violations of the Employee Retirement Income Security Act of 1974 ("ERISA"). In these cross motions for partial summary judgment, the parties ask this Court to decide whether or not John Hancock is a fiduciary with respect to the Sperry Trust within the meaning of ERISA, and subject, therefore, to the responsibilities that attend that status.

In deciding the limited question presented by the parties' motions here, this Court considers only the Group Annuity Contract No. 50, as amended, and facts to which the parties have stipulated. For the reasons following the Court concludes that there are no genuine issues of material fact; and the Court finds as a matter of law that John Hancock is not an ERISA fiduciary with respect to the Sperry Trust. Accordingly, the defendant's motion for partial summary judgment is granted and the plaintiff's motion is denied. Fed.R.Civ.P. 56.

BACKGROUND

The following is taken from the agreed statement of facts to which the parties have stipulated for the purposes of their motions.

As of March 1, 1941, the Sperry Corporation and the John Hancock Mutual Life Insurance Company entered into Group Annuity Contract No. 50 GAC ("GAC 50").[1] From its inception until December 31, 1967, GAC 50 was a deferred annuity contract, under which Sperry purchased deferred annuities from Hancock on an annual basis for each employee eligible under the terms of the Sperry Rand Master Retirement Trust No. 2 (the "plan" or the "Sperry Trust"), once that employee became entitled to benefits in accordance with the plan ("the covered employees").[2] Upon the purchase of any deferred annuity, Hancock guaranteed the payment of that annuity to the covered employee (and his or her beneficiaries) for life to the extent that the employee and beneficiaries would be entitled to such a payment. In other words, once a covered employee's benefits vested pursuant to the terms of the plan, Hancock would guarantee the covered employee's benefits.

By an amendment effective as of January 1, 1968, GAC 50 was converted to a direct-rated retrospective immediate participation guarantee ("retro-IPG") form of contract. Hancock IPG contracts are "participating" contracts, sharing in the aggregate of the contract's mortality, expense, and investment experience to the extent that that experience is more favorable than the experience assumed in the contract's purchase rates.[3] Net

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[1] On November 12, 1986, the Sperry Corporation and the Burroughs Corporation merged to form the Unisys Corporation. The Sperry Rand Master Retirement Trust No. 2 was then succeeded by the Unisys Master Trust.

[2] The deferred annuities were to be payable to the employees (or their beneficiaries) upon the employees' retirement.

[3] Since 1959, Hancock, with the approval of the New York State Insurance Department, has used the "investment generation" method for allocating

(Footnote continued)

investment income allocated to an IPG contract is directly credited on an annual basis to that contract's Pension Administration Fund ("PAF" or "IPG Fund"). The amount of the PAF depends in part on the investment performance of Hancock's general account and upon the allocation of that performance to GAC 50. Under the 1968 Amendment, Hancock guarantees that the PAF on any date will not be less than it otherwise would have been if the sum of the net interest earned and capital gains and losses apportioned to the PAF had always been zero from January 1, 1968.

Pursuant to the 1968 Amendment to GAC 50, annuities purchased for certain employees up to December 31, 1967 were "cancelled," but Hancock continued to guarantee benefits to those employees and their beneficiaries. The 1968 Amendment also established a method for the provision of additional benefits payable for the period after December 31, 1967. Under the amendment, upon an eligible employee's retirement Hancock would determine, pursuant to rate tables contained in GAC 50, the amount by which the Liabilities of the Fund ("LOF")[4] would increase if that portion of the employee's retirement benefit accruing in the period after January 1, 1968 were to be guaranteed

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investment income. The investment generation method tracks the net increase in the experience account of each contract for each year (the "cell") and credits each cell with the rate of return for general account assets acquired by Hancock in the original investment year, adjusted for "rollover," which includes the maturity, sale, call, and elimination through default of assets. Through its investment generation method, Hancock allocates income, capital gains or losses, expenses, and taxes to lines of business participating in the experience of Hancock's general account. The same method is used by Hancock for the purpose of allocations to IPG contracts.

[4] GAC 50's LOF as of January 1, 1968 was based upon rate tables, incorporated into and made a part of the contract, which contained two and a half percent and three percent interest rate assumptions and employed the 1937 Standard Annuity and 1951 Group Annuity Mortality Tables, with specified adjustments to reflect mortality improvement. Since as of 1968, Hancock has used and continues to use the interest rate assumptions incorporated in the 1968 Amendment's rate tables in its annual computation of the portion of GAC 50's LOF that pertains to the pre-1968 Annuities.

by Hancock.[5] If GAC 50's PAF balance exceeded the contract's Minimum Operating Level ("MOL") (equal to 105% of its LOF), based upon this increased LOF, Hancock would guarantee the payment of the additional benefits. If the amount of the PAF fell below the amount of the LOF (or if the amount of the PAF and its Supplemental Fund balances together fell below the amount of the MOL), Hancock could ask Sperry for a contribution.

The 1968 Amendment provided that if Sperry failed to maintain the PAF balance at least equal to the LOF (or to maintain GAC 50's PAF and Supplemental Fund balances at or above the MOL), the PAF could be "terminated." Upon termination of the PAF, the contract would cease to function as a retro-IPG contract, and would thereafter function as a deferred annuity contract. The termination of the PAF would also result in Hancock's "repurchase" of the pre-1968 Annuities and the purchase of annuities sufficient to provide the benefits guaranteed by Hancock in the period after January 1, 1968, at the rates set forth in the 1968 Amendment. As of January 1, 1968, GAC 50's PAF balance equalled its LOF. Since at least the early 1970s, GAC 50's PAF balance has exceeded the amount of its MOL (and thus its LOF). GAC 50 provides that if there is a balance in the PAF upon its termination, Hancock shall pay or apply that balance in a manner to be determined by mutual agreement between Hancock and the plan's trustee, Harris Trust.[6]

By an amendment effective as of August 1, 1977, GAC 50 was converted to a retrospective immediate participation

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[5] Hancock is required under GAC 50 to determine the LOF annually. In determining the LOF for GAC 50 Hancock each year has utilized the LOF rates incorporated into and made a part of the contract by the 1968 Amendment. As of January 1, 1968, the rates for the calculation of the portion of the LOF for retirement benefits guaranteed after December 31, 1967, incorporated a five percent interest factor and the 1951 Group Annuity Mortality Table, with specified adjustments to reflect mortality improvement.

[6] Harris Trust succeeded the Chase Manhattan Bank as trustee of the plan as of October 1, 1987.

guarantee/prospective deferred liability form of contract. Under the 1977 Amendment, GAC 50's LOF would not be increased automatically upon the retirement of any employee and new retirement benefits would not be guaranteed automatically by Hancock. On any date after August 1, 1977, the Sperry Retirement Committee ("SRC") could request that Hancock establish guaranteed benefits in addition to the benefits already guaranteed. Since the effective date of the 1977 Amendment, the SRC has not requested that Hancock establish any new guaranteed benefits.[7]

In November, 1988 Hancock transferred to Harris Trust, as trustee of the assets of the Sperry Rand Master Retirement Trust No. 2, approximately $53 million from out of the PAF.

DISCUSSION

I

The Employee Retirement Income Security Act of 1974 ("ERISA"), Pub.L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001 et seq.), is Congress's comprehensive and farreaching regulatory scheme to protect employee pensions. In Congress's own words, ERISA exists

> to protect ... the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.

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[7] The 1977 Amendment also provided for and permitted under certain circumstances the payment of "non-guaranteed benefits." The 1977 Amendment further provided that the monthly amount of non-guranteed benefits for eligible employees designated by the SRC, as well as any determination of eligibility for such benefits, would be determined solely by the SRC in accordance with the plan. Pursuant to the 1977 Amendment, Hancock paid non-guaranteed benefits on a monthly basis through June 1982.

Id. § 1001(b); *See Massachusetts v. Morash*, ___ U.S. ___, 109 S.Ct. 1668, 1671, 104 L.Ed.2d 98 (1989) (Congress passed ERISA "to safeguard employees from the abuse and mismanagement of funds that had been accumulated to finance various types of employee beneifts"); *see also* 29 U.S.C. § 1001a(c); *id.* § 1001b(c). ERISA's scope is broad; it applies, with certain exceptions not germane, to "any employee benefit plan if it is established or maintained" by employers engaged in interstate commerce. *Id.* § 1003(a). Congress's commerce clause power, of course, is virtually limitless, and its exercise of that power in enacting ERISA was manifestly proper. *See, e.g., Hewlett-Packard Co. v. Barnes*, 425 F.Supp. 1294, 1300-01 (N.D.Cal.1977), *aff'd* 571 F.2d 502 (9th Cir.) (per curiam), *cert. denied*, 439 U.S. 831, 99 S.Ct. 108, 58 L.Ed.2d 125 (1978). Neither Harris Trust nor John Hancock contends otherwise. Nor do the parties suggest that the Unisys Master Trust is anything but an "employee benefit plan," a term that ERISA explicitly defines. *See* 29 U.S.C. § 1002(3); *id.* § 1002(1); *id.* § 1002(2); *cf. Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 107 S.Ct. 2211, 96 L.Ed.2d 1 (1987).

John Hancock takes the position nonetheless that when it enacted ERISA Congress did not mean to "alter the way in which insurance companies invest and manage billions of dollars of assets and dislocate the . . . framework of state regulation that has historically governed the industry practices that are the subject of [Harris Trust's] claims." Memorandum of Defendant in Support of its Motion for Partial Summary Judgment at 4. ERISA's broad preemption clause directs that the statute "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. § 1144(a). The preemption clause is subject to the important qualification of the "saving clause," *id.* § 1144(b)(2)(A), which states that ERISA "shall [not] be construed to exempt or relieve any person from any law of any State which regulates insurance . . . ." According to Hancock, the Supreme Court held in *Metropolitan Life Insurance Co. v. Massachusetts*, 471 U.S. 724, 105 S.Ct. 2380, 85 L.Ed.2d 728 (1985), that the saving clause incorporates the McCarran-Ferguson Act, 15 U.S.C. § 1011 et seq., which leaves the regulation of the business of insurance

exclusively to the states. Hancock argues that with respect to GAC 50 it is engaged in the business of insurance; therefore, Hancock concludes, ERISA does not here apply. And Hancock does not shy away from the more general implication of its argument: that when an insurer is engaged in a particular practice that is part of the McCarran-Ferguson "business of insurance," the insurer is free of ERISA's strictures.

At first glance, Hancock's argument seems compelling. In interpreting ERISA's preemption clause, the Supreme Court has stressed that a state law "relate[s] to any benefit plan" "in the normal sense of the phrase, if it has a connection with or reference to such a plan." *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 97, 103 S.Ct. 2890, 2900, 77 L.Ed.2d 490 (1983); *see Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 45-46, 107 S.Ct. 1549, 1551-52, 95 L.Ed.2d 39 (1987) ("the express preemption provisions of ERISA are deliberately expansive, and designed to 'establish pension plan regulation as exclusively a federal concern' ") (quoting *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 523, 101 S.Ct. 1895, 1906, 68 L.Ed.2d 402 (1981)); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 739, 105 S.Ct. 2380, 2388-40, 85 L.Ed.2d 728 (1985). The saving clause then qualifies ERISA's preemptive effect. Discussing the saving clause in *Metropolitan Life*, the Supreme Court wrote:

> That mandated-benefit laws fall within the terms of the definition of insurance in the McCarran-Ferguson Act is directly relevant in another sense as well. Congress' "primary concern" in enacting McCarran-Ferguson was to "ensure that the States would continue to have the ability to tax and regulate the business of insurance." That Act provides: "The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." The ERISA saving clause, with its similarly worded protection of "any law of any State which regulates insurance," appears to have been designed to preserve the McCarran-Ferguson Act's reservation of the business of insurance to the States. The saving

> clause and the McCarran-Ferguson Act serve the same federal policy and utilize similar language to define what is left to the States. Moreover, § 514(d) of ERISA, 29 U.S.C. § 1144(d), explicitly states in part: "Nothing in [ERISA] shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States." Thus application of the McCarran-Ferguson Act lends further support to our ruling that Congress did not intend mandated-benefit laws to be preempted by ERISA.

Metropolitan Life, 471 U.S. at 744 n. 21, 105 S.Ct. at 2391 n. 21 (citations omitted).

Read alone, the *Metropolitan Life* footnote does support Hancock's argument. Yet alone is how the footnote *must* be read to support Hancock's argument, for no case decided before or since, by the Supreme Court or any lower federal or state court, has gone as far. The footnote's context shows why not.

To begin with, footnote 21 is dictum. A close reading of *Metropolitan Life* demonstrates that the Supreme Court merely borrowed its McCarran-Ferguson analysis from prior cases to illuminate the similar statutory words of ERISA's saving clause. In *Metropolitan Life* the Court took a "common-sense view of the matter" and found that a Massachusetts law governing the content of general health plans was clearly one "which regulates insurance" within the meaning of the saving clause. 471 U.S. at 740, 105 S.Ct. at 2389. The Court then buttressed its conclusion by noting that state laws regulating the content of insurance contracts "relate to the regulation" of the "business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012(a), as well. *See* 471 U.S. at 742-44, 105 S.Ct. at 2390-92. In evaluating the McCarran-Ferguson "business of insurance," courts typically consider the factors delineated in *Union Life Insurance Co. v. Pireno*, 458 U.S. 119, 129, 102 S.Ct. 3002, 3008-09, 73 L.Ed.2d 647 (1982),[8] and the

[8] Those criteria are "*First*, whether the practice has the effect of transferring or spreading a policyholder's risk, *second*, whether the practice is an integral

(Footnote continued)

Massachusetts statute met all three of the *Pireno* criteria. In short, the "traditional understanding of insurance regulation," embodied in McCarran-Freguson and elucidated in *Pireno*, combined with the "plain language of thc [ERISA] saving clause [and] its relationship to the other ERISA pre-emption provisions," together spared the Massachusetts law. *See Metropolitan Life*, 471 U.S. at 742-44, 105 S.Ct. at 2391-91. The petitioners in *Metropolitan Life* did not argue that ERISA did not apply at all, and, notwithstanding its footnote, the Court did not so hold.

Hancock argues that the practices of which Harris Trust complains constitute the "business of insurance," traditionally overseen and regulated by state insurance departments, and that under *Metropolitan Life* ERISA does not therefore apply. Taken to its logical extreme, Hancock's argument means that if ERISA does not preempt a state statute, the state statute, in effect, preempts ERISA. Yet ERISA's saving clause does not itself include Hancock's additional words, and the legislative history of the clause, which is sparse, does not fill in Hancock's putative statutory gap. *See Metropolitan Life*, 471 U.S. at 745 & nn. 22 & 23, 105 S.Ct. at 2392, nn. 22 & 23. This Court does not read *Metropolitan Life* or ERISA in that manner. ERISA need in no way alter traditional preemption analysis.[9] A court should

part of the policy relationship between the insurer and the insured, and *third*, whether the practice is limited to entities within the insurance industry." *Metropolitan Life*, 471 U.S. at 743, 105 S.Ct. at 2391 (quoting *Pireno*, 458 U.S. at 129, 102 S.Ct. at 3009 (emphasis in original)).

[9] *See, e.g., Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248, 104 S.Ct. 615, 621, 78 L.Ed.2d 443 (1984) (citations omitted):

> [S]tate law can be pre-empted in either of two general ways. If Congress evinces an intent to occupy a given field, any state law falling within that field is preempted. If Congress has not entirely displaced state regulation over the matter in question, state law is still pre-empted to the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law, or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress.

not look to insurance company business practices in inquiring into ERISA preemption but, as the Supreme Court did in *Metropolitan Life*, should instead look to state statutes and common law causes of action. This interpretation of the Supreme Court's approach in *Metropolitan Life* is confirmed by the Supreme Court's approach in *Pilot Life Insurance Co. v. Dedeaux*, 481 U.S. 41, 107 S.Ct. 1549, 95 L.Ed.2d 39 (1987), a case that is *Metropolitan Life's* complement. In *Metropolitan Life* the Court held that the Massachusetts mandated-benefits law was saved from ERISA preemption because it regulated insurance. In *Pilot Life* the Court held that Mississippi's common law tort and contract actions for improper claims processing did *not* regulate insurance, and *were*, therefore, preempted. The Supreme Court in *Metropolitan Life* and *Pilot Life*, and lower courts in other cases construing the saving clause, have used the language and case law of the McCarran-Ferguson Act to decide whether state laws ostensibly preempted, are, or are not, preserved. *E.g., Northern Group Servs Co. v. Auto Owners Ins. Co.*, 833 F.2d 85, 89-90 (6th Cir.1987). If a state statute meets the *Metropolitan Life* test, and thus fits ERISA's saving clause, the state law applies to the plan at issue. But ERISA applies to the plan as well.

Metropolitan Life is itself illustrative: because the Massachusetts law survived preemption, the decision "result[ed] in a distinction between insured and uninsured plans, leaving the former open to indirect regulation while the latter are not." *Metropolitan Life*, 471 U.S. at 747, 105 S.Ct. at 2393. While an uninsured plan would be subject solely to ERISA, an insured plan would be covered by both ERISA *and* the state law. *See id.; id.* at 748 n. 25, 105 S.Ct. at 2393 n. 25. This system of dual regulation comports with the language of the preemption and saving clauses, 29 U.S.C. § 1144, which save certain state statutes from preemption, but which also assume that ERISA applies ab initio. As the Seventh Circuit has written (in a case that predates *Metropolitan Life*),

> [t]hat ERISA does not relieve insurance companies of the onus of state regulation does not mean that Congress intended ERISA not to apply to insurance companies. Had that been Congress'[s] intent ... ERISA would have directly stated that is was preempted by state insurance laws. *Congress clearly intended that insurance companies be subject to dual regulation.*

Chicago Bd. Options Exch., Inc. v. Connecticut Gen. Life Ins. Co., 713 F.2d 254, 260 (7th Cir.1983) (emphasis added). If the New York and Massachusetts state laws that govern Hancock's behavior relate to employee benefit plans and regulate the business of insurance, the laws would survive ERISA preemption.[10] The state statutes *and* ERISA would both apply to the insurer's activities.

This system of dual regulation thus harmonizes ERISA and McCarran-Ferguson, at least to the extent that state and federal law do not directly conflict.[11] In this case, the relevant state laws do not clash with any provisions of ERISA, with one seeming exception. Mass.Gen.L. ch. 175, § 66B permits an insurance company to invest its general account assets in home office properties. ERISA flatly prohibits that type of investment. *See* 29 U.S.C.

[10] Among the statutes that Hancock cites are: N.Y. Ins. Law § 4224(a)(1) (prohibiting "unfair discrimination between individuals of the same class ... in the amount of payment or the return of premiums or rates charged for policies ... or in the dividends or other benefits"); N.Y. Ins. Law § 4226(a) (prohibiting unfair trade practices); N.Y. Ins. Law § 3201(b)(1) (requiring superintendent's approval of policy); Mass. Gen.L. ch. 175. § 93E (requiring insurers to keep surplus as reserves for obligation); Mass. Gen.L. ch. 175. §§ 63, 66B (regulating types of investments permissible for general accounts). Harris Trust concedes that each of the laws relates to employee benefit plans and that most of them probably regulate the business of insurance. *See* Plaintiff's Memorandum in Opposition to Defendant's Motion for Partial Summary Judgment app. A at 1-11.

[11] At least one lower court has held that a state law is preempted notwithstanding its coverage by the saving clause, since Congress intended to make the subject of that law ERISA's exclusive concern. *Lee v. Prudential Ins. Co.*, 673 F.Supp. 998, 1000-02 (N.D.Cal.1987) (California statute providing private cause of action for unfair claims settlement practices meets McCarran Ferguson "business of insurance" test for ERISA saving clause purposes, but preempted nonetheless because Congress meant to make ERISA's civil enforcement provisions exclusive); *cf. Kanne v. Connecticut Gen. Life Ins. Co.*, 859 F.2d 96, 100 (9th Cir.1988).

§ 1106. Nonetheless, the ERISA prohibition applies only to fiduciaries. Given this Court's conclusion that Hancock is not a fiduciary with respect to the Sperry plan, Hancock may invest its general account assets without violating ERISA's fiduciary requirements. *Cf. e.g., Fitzsimmons v. Old Security Life Ins. Co.,* Fed.Sec.L.Rep. (CCH) ¶ 96,236, 1977 WL 1057 (N.D.Ill.1977).

In further support of its argument that it is governed by state law, and exempt from ERISA, Hancock then turns to another section of ERISA itself, which provides that "[n]othing in [ERISA] shall be construed to alter, amend, modify, invalidate, or supersede any law of the United States ...." 29 U.S.C. § 1144(d), *quoted in Metropolitan Life*, 471 U.S. at 744 n. 21, 105 S.Ct. at 2391 n. 21. The McCarran-Ferguson Act, of course, is a law of the United States. Congress drafted McCarran-Ferguson "broadly to give support to the existing and future state systems for regulating and taxing the business of insurance," *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429, 66 S.Ct. 1142, 1154-55, 90 L.Ed. 1342 (1946), *quoted in SEC v. National Sec., Inc.*, 393 U.S. 453, 458, 89 S.Ct. 564, 567-68, 21 L.Ed.2d 668 (1969); *see also State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451, 452, 82 S.Ct. 1380, 1381-82, 8 L.Ed.2d 620 (1962); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 218 n. 18, 99 S.Ct. 1067, 1077 n. 18, 59 L.Ed.2d 261 (1979); to "turn back the clock" and reinvest states with the exclusive regulation of the business of insurance, *see, e.g., Idaho ex rel. Soward v. United States*, 858 F.2d 445, 449-50 (9th Cir.1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 2063, 104 L.Ed.2d 628 (1989). As Hancock shows, and as Harris Trust apparently concedes, the practices of which Harris Trust complains are clearly part of the "business of insurance" within the meaning *Pireno. See* Memorandum of Defendant in Support of its Motion for Partial Summary Judgment at 25-33. The Sperry Trust would therefore come under McCarran-Ferguson. The trust just as clearly relates to an employee benefit plan, however, and it clearly comes under ERISA's purview as well. If ERISA and McCarran-Ferguson were really mutually exclusive, as Hancock contends, the two statutes would collide head on.

By its own terms, however, McCarran-Ferguson gives way. 15 U.S.C. § 1012(b) provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance ... unless such Act specifically relates to the business of insurance ...." ERISA fits the McCarran-Ferguson exception for laws that specifically relate to the business of insurance. *See Spirt v. Teachers Ins. & Annuity Ass'n*, 691 F.2d 1054, 1065 (2d Cir.1982) (ERISA is "a statute which clearly 'specifically relates to the business of insurance' "), *vacated on other grounds and remanded*, 463 U.S. 1223, 103 S.Ct. 3566, 77 L.Ed.2d 1406, (1983); *Hewlett-Packard Co. v. Barnes*, 571 F.2d 502, 505 (9th Cir.) (per curiam) (there are "ERISA sections that undeniably 'specifically relate' to the business of insurance.... If McCarran-Ferguson applies, therefore, ERISA falls within the clause excepting federal laws that 'specifically relate' to the business of insurance."), *cert. denied*, 439 U.S. 831, 99 S.Ct. 108, 58 L.Ed.2d 125 (1978). Indeed, the "deemer" clause, 29 U.S.C. § 1144(b)(2)(B), uses the McCarran-Ferguson Act's very term of art: it provides that no employee benefit plan "shall be deemed to be an insurance company ... or to be engaged in the business of insurance ... for the purposes of any law of any State purporting to regulate insurance companies." The "guaranteed benefit policy" exception provides:

> For purposes of this part:
>
> * * * * *
>
> (2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:
>
> * * * * *
>
>> (B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer....

29 U.S.C. § 1101(b); *see also Spirt, supra*, 691 F.2d at 1065 ("Congress, in enacting a statute primarily intended to deal with the conflict between state regulation of insurers and the federal antitrust laws, had no intention of declaring that subsequently enacted civil rights legislation would be inapplicable to any and all of the activities of an insurance company that can be classified as the 'business of insurance' "); *Women in City Gov't United, Inc. v. City of New York*, 515 F.Supp. 295, 302-06 (S.D.N.Y.1981) (Title VII, "incorporated by reference into ERISA," applies to insurers, for "Congress'[s] concern that discrimination in employee benefits be prohibited outweighed the interest it had in the insurance industry and in the preservation of state insurance regulation").

Hancock is subject to dual regulation here for a further reason. As the Second Circuit has explained,

> [t]he McCarran[-Ferguson] Act does not ... exempt the business of insurance from the coverage of all federal statutes which do not specifically state that their provisions are applicable to insurance.... "[T]he McCarran-Ferguson Act was not intended to preclude the application of these federal statutes *unless* they invalidate, impair or supersede applicable State legislation regulating the business of insurance."

Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co., 408 F.2d 606, 611 (2d Cir.1969) (quoting 291 F.Supp. 225, 230 (S.D.N.Y.1968)). As discussed above, ERISA does not necessarily "invalidate, impair, or supersede" any of the state laws to which Hancock is subject. *See Mackey v. Nationwide Ins. Cos.*, 724 F.2d 419, 421 (4th Cir.1984) (Fair Housing Act would not adversely affect state laws regulating business of insurance); *Miller v. National Fidelity Life Ins. Co.*, 588 F.2d 185, 186-87 (5th Cir.1979) (same conclusion concerning Federal Arbitration Act); *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 611 (2d Cir.1969) (same). Because there is no conflict between them here, McCarran-Ferguson permits ERISA and state regulation of insurance to co-apply.

On more than one occasion the Supreme Court has remarked that ERISA's preemption and saving clauses "perhaps are not a model of legislative drafting." *Pilot Life, supra*, 481 U.S. at 46, 107 S.Ct. at 1552 (quoting *Metropolitan Life*, 471 U.S. at 739, 105 S.Ct. at 2389). In arguing that ERISA does not apply in this case at all, Hancock would add its own gloss to ERISA's words. Without more substantial language from Congress, however, or further guidance from the Supreme Court, this Court will not read in what Congress has not written. Accordingly, this Court holds that it must construe ERISA in resolving this motion.

II

Having concluded that ERISA is applicable to this dispute, the Court must now consider whether to give collateral estoppel effect to a decision rendered in *Jacobson v. John Hancock Mutual Life Insurance Co.*, Civ. No. N-84-663 (PCD): Ruling on Motion for Summary Judgment, 655 F.Supp. 1290 (D.Conn.), *judgment withdrawn and vacated pursuant to settlement*, 662 F.Supp. 1103, 1112-13 (1987).

The plaintiffs in *Jacobson* were the trustees of a union pension fund who had entered into a contract called the Group Annuity Contract No. 738 ("GAC 738") with John Hancock, the *Jacobson* defendant. In its original incarnation GAC 738 was a deposit administration contract ("DAC").[13] On January 1, 1973, GAC 738 became an immediate participation guarantee contract. Judge Dorsey described the IPG contract as follows:

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[13] Under the DAC regime, payments to Hancock were held in an "unallocated fund during the active lives of the participants." Hancock "periodically credited [the account] with interest and additional dividends could be credited depending on the fruitfulness of [Hancock's] investment strategies." "When a plan beneficiary retired, died, or became disabled, the amount of the premiums required to ensure the participant the benefits to which he was entitled under the plan was withdrawn and used to purchase an annuity." 662 F.Supp. at 1104 (citations omitted).

"The IPG [was] the fund in which amounts [were] accumulated by [defendant] to be used for the payment of the benefits provided under [the] contract." Employers of plan beneficiaries paid to plaintiffs [certain] amounts.... Those funds were then paid by plaintiffs to defendant.... A separate reserve was established by defendant as part of the IPG (referred to as the Liability of the Fund ("LOF")), from which annuities were purchased to meet the pension entitlement of a participant. "The [LOF] on any date was the sum of the amounts required to enable [defendant] to fulfill its guarantees with respect to: (a) the benefits established under [the contract], and (b) any due and unpaid amounts chargeable to the [IPG]." The mathematical formula designed to make the LOF calculations were fixed in the contract. At no time could plaintiffs' contributions fall below the minimal amount necessary to operate the fund—equal to 110% of the LOF.

Defendant "assume[d] no liability as to the sufficiency of [IPG] to provide for the benefits under [the] contract other than those benefits for which amounts [were] included in the LOF." Defendant was liable, however, for the contributions made to and for pension benefits once a participant's entitlement was fixed.... When an entitlement was determined, defendant credited the LOF with an amount necessary to pay the benefit. Defendant then commenced periodic payments in accordance with the entitlement. Defendant guaranteed those payments. Plaintiffs were obligated to make additional contributions to cover any shortfall experienced by the LOF. In default of such contributions, defendant's obligation to pay benefits was reduced by a percentage determined by the LOF shortfall.

"Contributions payable [to IPG were] assigned to the General Investment Account ["GIA"]...." The contributions actually made [to the IPG] were pooled

by defendant with its other contractholders' funds and invested.... The IPG differed from the DAC in that the latter established a partially fixed investment return and set the operating expenses at a fixed rate. The return on the investment in the IPG, however, depended entirely on the investment performance of defendant's GIA. Also, under the IPG, plaintiffs were charged with defendant's actual costs. The IPG accounts were adjusted annually to reflect the net investment experience minus expenses and taxes....

662 F.Supp. at 1104-05 (citations omitted).

In their complaint the *Jacobson* plaintiffs alleged that Hancock had violated the fiduciary requirements set out in 29 U.S.C. §§ 1104(a)(1), 1106(a)(1)(D), and 1106(b)(1)–(2). They then moved for partial summary judgment on the issue of Hancock's status as a fiduciary. In *Jacobson v. John Hancock Mutual Life Insurance Co.*, 655 F.Supp. 1290, *judgment withdrawn and vacated pursuant to settlement*, 662 F.Supp. 1103, 1112-13 (D.Conn.1987)). Judge Dorsey granted the plaintiffs' motion.

Judge Dorsey first decided that although the guaranteed benefit policy exception, 29 U.S.C. § 1101(b)(2)(B), "does indeed provide a safe harbor to insurance companies that sell standard annuity contracts to cover the anticipated needs of the relevant pension plan," that section "cover[s] only that phase of a contract in which the obligation of the insurer to guarantee the benefits payable to plan participants is fixed," and is therefore unavailing when "the level of funds available to support benefits which may become due fluctuates with the investment return of the insurer." 662 F.Supp. at 1107-08.[13] Judge Dorsey reviewed

[13] Judge Dorsey reasoned that "unlike the guaranteed annuity contract, benefits of any or all participants are not guaranteed under GAC 738 so long as the fund contributions are subject to the investment results achieved by the insurer.

(Footnote continued)

the legislative history of the guaranteed benefit policy exception and found that it "reflect[ed] a congressional intent to cloak the managers of both [general accounts and separate accounts] with fiduciary status." *Id.* at 1109.[14] He then considered Department of Labor Interpretive Bulletin 75-2, 29 C.F.R. § 2509.75-2 (1985), which supported Hancock's position. Judge Dorsey suggested that it was "an aberration in what ha[d] otherwise been a consistent [Labor Department] policy," and consequently, paid it no deference. *See id.* at 1109-11. Finally, Judge Dorsey examined Hancock's responsibilities under GAC 738 and decided that it "exercised significant control over the management of the plan." *Id.* at 1112. "Accordingly," he concluded, "[Hancock] is held to the standards of a fiduciary." *Id.*

According to Harris Trust, "the full spectrum of judicial concerns and public interests embodied in preclusion doctrine" demand that Judge Dorsey's desision preclude John Hancock from relitigating the issue raised in this motion. In other words, Harris Trust avers, Hancock should not be allowed to take "the proverbial 'second bite at the apple.' " Plaintiff's Reply Memorandum in Support of its Motion for Partial Summary Judgment at 68, 75.

The doctrine of issue preclusion holds that "once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979) (citing *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 n. 5, 99 S.Ct. 645, 649 n. 5, 58

Poor investment results might reduce or even exhaust the funds below the level sufficient to pay benefits as they become fixed and payable. It is this contingency which § 1101(b)(2) addresses." 662 F.Supp. at 1108.

[14] "This distinction [between general and separate accounts] ... is irrelevant in identifying plan assets for purposes of § 1101(b)(2), since that section only distinguishes between accounts which guarantee benefits or returns and accounts which do not make such guarantees. Thus, only accounts which guarantee fixed returns and fixed benefits are sheltered." 662 F.Supp. at 1109.

L.Ed.2d 552 (1979)). As the Supreme Court has written, "[t]o preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions." *Id.* 440 U.S. at 153-54, 99 S.Ct. at 973-74; *see also Parklane Hosiery*, 439 U.S. at 326, 99 S.Ct. at 649 (issue preclusion, or "[c]ollateral estoppel, ... has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation") (citing *Blonder-Tongue Laboratories, Inc. v. University of Illinois Found.*, 402 U.S. 313, 328-29, 91 S.Ct. 1434, 1442-43, 28 L.Ed.2d 788 (1971)); 18 C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure* § 4416 (1981) [hereinafter Wright & Miller].

Judge Dorsey's entry of summary judgment against John Hancock in *Jacobson*, 655 F.Supp. 1290, could therefore warrant a similar order here. Federal trial courts enjoy "broad discretion" to decide when to apply issue preclusion offensively[15] *Parklane Hosiery*, 439 U.S. at 331, 99 S.Ct. at 1444. Judge Dorsey's order meets all the criteria of *Parklane Hosiery*.[16]

[15] A case "involves offensive use of collateral estoppel" when, as here, "a plaintiff is seeking to estop a defendant from relitigating the issues which the defendant previously lost in an earlier action." *Parklane Hosiery*, 439 U.S. at 329, 99 S.Ct. at 1443.

[16] *Cf. GAF Corp. v. Eastman Kodak Co.*, 519 F.Supp. 1203, 1211 (S.D.N.Y. 1981) (Pierce, J.): "Briefly stated, the following are preconditions to the application of collateral estoppel: (1) the party against whom collateral estoppel is asserted must have been a party, or in privity with a party, to the prior action; (2) there must have been a final determination of the merits of the issues sought to be collaterally estopped; (3) the issues sought to be precluded must have been necessary, material, and essential to the prior outcome; (4) the issues sought to be precluded must have been actually litigated in the prior action, with the party against whom the estoppel is asserted having had a full and fair opportunity to litigate the issues; and (5) the issues actually and necessarily decided in the prior litigation must be identical to the issues sought to be estopped."

Hancock was an actual party to *Jacobson*, and Judge Dorsey gave it an opportunity to present its case. *See Hansberry v. Lee*, 311 U.S. 32, 40, 61 S.Ct. 115, 117, 85 L.Ed. 22 (1940). Judge Dorsey's ruling was "an adequate and firm determination of one issue in a given action [and Harris Trust] need not await the resolution of the remaining issues before obtaining preclusive effect in a subsequent action." *Morano v. Dillon*, 746 F.2d 942, 945 n. 4 (2d Cir.1984) (per curiam) (citing *Zdanok v. Glidden Co.*, 327 F.2d 944, 955 (2d Cir.) (Friendly, J.), *cert. denied*, 377 U.S. 934, 84 S.Ct. 1338, 12 L.Ed.2d 298 (1964)); *see Lummus Co. v. Commonwealth Oil Refining Co.*, 297 F.2d 80, 89 (2d Cir.1961) (Friendly, J.) (" 'Finality' in the context here relevant may mean little more than that the litigation of a particular issue has reached such a stage that a court sees no really good reason for permitting it to be litigated again."), *cert. denied*, 368 U.S. 986, 82 S.Ct. 601, 7 L.Ed.2d 524 (1962); *United States ex rel. DiGiangiemo v. Regan*, 528 F.2d 1262, 1265 (2d Cir.1975), *cert. denied*, 426 U.S. 950, 96 S.Ct. 3172, 49 L.Ed.2d 1187 (1976); *Kurlan v. Commissioner of Internal Revenue*, 343 F.2d 625, 628 n. 1 (2d Cir.1965); *cf.* Wright & Miller, *supra*, §§ 4432-4434; *Teachers Ins. & Annuity Ass'n of Am. v. Butler*, 803 F.2d 61, 66 (2d Cir.1986). In his opinion Judge Dorsey addressed the same issues raised by the motions here, and though the contract in *Jacobson* is not identical to the one in this action, the contractual features that differed in GAC 738 were probably "not of controlling significance." *Montana*, 440 U.S. at 160, 99 S.Ct. at 977.[17] Nor has Congress changed any "controlling legal principles"

[17] Both GAC 50 and GAC 738 were retrospective IPG contracts converted from other types of group annuity contracts, both provided for the cancellation of the annuities purchased prior to conversion and the placing of the monies in funds held in Hancock's general investment account; and both contemplated payments to fund beneficiaries directly from that fund. *See generally* Memorandum in Support of Plaintiff's Motion for Partial Summary Judgment at 66-69. It is true that GAC 738 did not contain a provision capping the risk charges at one percent, a provision germane to Hancock's argument that GAC 50 is an insurance contract, not an investment contract; and that GAC 738 was originally a deposit administration contract, not a deferred annuity contract, which seems to be a guaranteed benefit policy. Given the decision in *Nestle*, however, it is unnecessary to decide whether these distinctions would be important enough to preclude the application of collateral estoppel.

since. *Id.* at 161. 99 S.Ct. at 977-78. Finally, "none of the circumstances that might justify reluctance to allow the offensive use of collateral estoppel is present," *Parklane Hosiery*, 439 U.S. at 331, 99 S.Ct. at 652, Harris Trust could not have joined in the *Jacobson* action; Hancock, well aware of the magnitude of the stakes in *Jacobson*, "had every incentive to litigate the ... lawsuit fully and vigorously," 439 U.S. at 332, 99 S.Ct. at 652; and Judge Dorsey's decision did not conflict with any other court's approach to the same issue—since no other court had yet faced it. In sum, under ordinary circumstances claim preclusion here would not be "unfair," *id.* at 331, 99 S.Ct. at 651-52, and the "contemporary law of collateral estoppel [should] lead[] inescapably to the conclusion that [Hancock] is collaterally estopped from relitigating the question" of whether it is an ERISA fiduciary, *id.* at 333, 99 S.Ct. at 652-53.

Jacobson, however, was not an ordinary case. Shortly after Judge Dorsey decided, on a motion for reconsideration, to adhere to his ruling on the motion for partial summary judgment, Hancock and the union trustees settled their dispute. The parties expressly conditioned settlement on "the entry of a final judgment by the Court pursuant to which (a) the order is withdrawn, set aside and vacated, and made of no further force or effect for use against defendant, ... by the Pension Fund, or by third parties, for collateral estoppel or other preclusive purposes," 662 F.Supp. at 1113, and Judge Dorsey, bound by the rule of *Nestle Co. v. Chester's Market, Inc.*, 756 F.2d 280 (2d Cir.1985), entered an order that embodied the parties' agreement. Harris Trust argues that Judge Dorsey's order, though withdrawn, should nonetheless preclude Hancock from relitigating what it has already lost. In support Harris Trust relies on *Chemetron Corp. v. Business Funds, Inc.*, 682 F.2d 1149, 1187-92 (5th Cir.1982), *vacated on other grounds and remanded*, 460 U.S. 1007, 103 S.Ct. 1245, 75 L.Ed.2d 476 (1983); *cf. Angstrohm Precision, Inc. v. Vishay Intertechnology, Inc.*, 567 F.Supp. 537, 540-41 (E.D.N.Y. 1982). One of the defendants in *Chemetron* had previously defended a securities fraud action arising out of the same stock manipulation scheme, and the trial judge in that prior action had filed a lengthy opinion detailing his findings of fact and awarding the plaintiff in the suit almost three quarters of a

million dollars. Before the court actually entered judgment, the parties agreed to settle on the condition that the judge set aside his findings of fact. Later, in *Chemetron* itself, the plaintiff, which had not been a party to the prior action, asked the court to preclude the defendant common to both suits from relitigating the issues of fact that the judge in the prior action had withdrawn. After considering the factors mentioned in *Parklane Hosiery*, the Fifth Circuit held that offensive, nonmutual preclusion was fully warranted—the settlement notwithstanding:

> Tactically [the defendant] chose to litigate fully, ... risking an adverse decision. He lost on that risk, and only when he lost did he decide to settle, fearing offensive collateral estoppel. Yet now he seeks to avoid the consequences of that risk by elevating form over substance. He cannot have it both ways. The findings of fact against [the defendant] in [the prior action] are sufficiently final to permit their use in this case. On remand, [he] should be collaterally estopped from relitigating those facts.

682 F.2d at 1191-92.

As Harris Trust notes, *Chemetron's* result makes some sense here: Judge Dorsey has already considred the issues raised by these motions, and forcing this Court to reconsider his thorough opinion would waste judicial resources. *Cf. Montana v. United States*, 440 U.S. at 153-54, 99 S.Ct. at 973-74. Harris Trust contends that the precise issue decided in *Chemetron* remains unanswered in the Second Circuit. It urges this Court to adopt the Fifth Circuit's approach. *Nestle Co. v. Chester's Market, Inc.*, 756 F.2d 280 (2d Cir.1985), however, suggests that for this Court, at least, the holding in *Chemetron* is foreclosed.

Shortly after Judge Blumenfeld ruled in *Nestle* in the defendant's favor on a motion for partial summary judgment, the parties negotiated a settlement conditioned on the vacatur of the opinion and judgment. Judge Blumenfeld then refused the parties' joint motion to vacate. *Nestle*, 596 F.Supp. 1445 (D.Conn.1984). On appeal, the Second Circuit reversed. Judge Winter began his opinion by finding that the dispute was not

moot, and that vacatur was not required by the rule of *United States v. Munsingwear, Inc.*, 340 U.S. 36, 41, 71 S.Ct. 104, 107, 95 L.Ed. 36 (1950). Because of the settlement, however, vacatur would moot the action. "[W]e are faced," he wrote, "with a settlement that will bring pending litigtion to an end. Because the policies favoring finality of judgments are intended to conserve judicial and private resources, the denial of the motion for vacatur is counter-productive because it will lead to more rather than less litigation." *Nestle*, 756 F.2d at 282. Judge Winter continued: "It is instructive to note that where the parties have not reached a settlement and where vacatur of a district court's judgment might deprive a party of protection it had fairly won, we have not directed vacatur." *Id.* at 283. In sum, in the Second Circuit, "the importance of honoring settlements" outweighs "the finality of final judgments." *Id.*; *see also Federal Data Corp. v. SMS Data Products Group*, 819 F.2d 277 (Fed.Cir.1987). *Contra Matter of Memorial Hospital of Iowa County*, 862 F.2d 1299 (7th Cir.1988); *Ringsby Truck Lines, Inc. v. Western Conference of Teamsters*, 686 F.2d 720 (9th Cir.1982), *criticized in Nestle*, 756 F.2d at 283 n. 4.

Harris Trust argues that Judge Winter did not address the question presented here, and it quotes a sentence in which he wrote, "We are ... not faced with new litigation which seeks to avoid directly or indirectly an otherwise final judgment, such as ... a claim that a judgment previously entered in litigation between the parties over the same subject matter is not preclusive." *Id.* at 282; *see also* Note, "Avoiding Issue Preclusion by Settlement Conditioned upon the Vacatur of Entered Judgments," 96 *Yale L.J.* 860, 862 (1986). Yet the sentence's context makes clear that Judge Winter was explaining why Judge Blumenfeld's denial of the motion to vacate would lead to more litigtion—an otherwise unnecessary appeal—, and that Judge Winter referred to the preclusive effect of a valid, *unvacated* prior judgment as an example of when a district court might legitimately consider finality more important than settlement. Indeed, virtually every other sentence in Judge Winter's opinion suggests that litigants prepared to settle may contract with impunity over the preclusive effects of their dispute. A district judge in the Second Circuit must follow that lead. Judge Winter's

views are well stated in a passage he quotes from a leading treatise:

> All of the policies that make voluntary settlement so important a means of concluding litigation apply. The appellee as well as the appellant may prefer settlement, and can bargain for whatever future protection it needs. *It cannot be argued that the possible nonmutual preclusion interests of nonparties justify either appellate decision against the wishes of the parties, or an insistence that as a price of settlement the appellant must permit the district court judgment to support nonmutual preclusion.* The parties should remain free to settle on terms that require vacation of the judgment, entry of a new consent judgment, or such other action as fits their needs.

Wright & Miller, *supra*, § 3533.10, at 432, *quoted at* 756 F.2d at 283 (emphasis added).[18]

In sum, the decision in *Jacobson v. John Hancock Mutual Life Insurance Co.*, 655 F.Supp. 1290 (D.Conn.), *judgment withdrawn*

[18] Judge Easterbrook spoke for the opposite view in *Matter of Memorial Hospital of Iowa County*, 862 F.2d at 1300, 1302:

> We always deny these motions [to vacate judgments after settlement] to the extent they ask us annul the district court's acts, on the ground that an opinion is a public act of the government, which may not be expunged by private agreement. History cannot be rewritten. There is no common law writ of erasure.... When a clash between genuine adversaries produces a precedent, ... the judicial system ought not allow the social value of that precedent, created at cost to the public and other litigants, to be a bargaining chip in the process of settlement. The precedent, a public act of a public official, is not the parties' property.... To the extent an opinion permits the invocation of *Parklane [Hosiery]*, it may have great value to strangers – a value that one may try to approximate in settlement, but which is not theirs to sell. If parties want to avoid stare decisis and preclusive effects, they need only settle before the district judge renders a decision, an outcome our approach today encourages.

and vacated pursuant to settlement, 662 F.Supp. 1103, 1112-13 (1987), does not preclude John Hancock from relitigating the issues presented before Judge Dorsey. This opinion will now continue to consider the merits of the motions raised here.

III

The final issue presented by these motions requires that this Court interpret the language of ERISA's fiduciary sections. Justice Marshall recently described the proper method of construing a statute:

> Ordinarily, we ascertain the meaning of a statutory provision by looking to its text, and, if the statutory language is unclear, to its legislative history. Where these barometers offer ambiguous guidance as to Congress' intent, we defer to the interpretation of the provision articulated by the agencies responsible for its enforcement, so long these agency interpretations are "based on a permissible construction of the statute."

Public Employees Retirement Sys. v. Betts, – U.S. –, 109 S.Ct. 2854, 2870, 106 L.Ed.2d 134 (1989) (Marshall, J., dissenting) (quoting *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843, 104 S.Ct. 2778, 2781-82, 81 L.Ed.2d 694 (1984)). Because the statutory provisions here have gone relatively unexamined, the more general words of Judge Learned Hand are particularly worthy of note:

> It is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.

Cabell v. Markham, 148 F.2d 737, 739 (2d Cir.), *aff'd*, 326 U.S. 404, 66 S.Ct. 193, 90 L.Ed. 165 (1945); *see also Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 51, 107 S.Ct. 1549, 1554, 95 L.Ed.2d 39 (1987) ("in expounding a statute, we [are] not ... guided

by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy"), *quoted in Massachusetts v. Morash*, — U.S. —, 109 S.Ct. 1668, 1673, 104 L.Ed.2d 98 (1989).

The purpose and object of ERISA are set out in Congress's "findings and declaration of policy." Congress enacted ERISA *"to protect . . . the interests of participants in employee benefit plans and their beneficiaries."* 29 U.S.C. § 1001(b). ERISA's legislative history is replete with comments that confirm that Congress intended to protect individual employees. The House Committee on Education and Labor, for example, wrote that "the primary purpose of [ERISA] is the protection of individual pension rights. . . ., to improve the equitable character and soundness of private pension plans." H.R.Rep. No. 93-533, 93d Cong., 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 4639, 4639, 4655. As the House Ways and Means Committee explained,

> One of the most important matters of public policy facing the nation today is how to assure that individuals who have spent their careers in useful and socially productive work will have adequate incomes to meet their needs when they retire. This legislation is concerned with improving the fairness and effectiveness of qualified retirement plans in their vital role of providing retirement income. In broad outline, the objective is to increase the number of individuals participating in employer-financed plans; [and] to make sure to the greatest extent possible that those who do participate in such plans actually receive benefits. . . .

H.R.Rep. No. 93-807, 93d Cong., 2d Sess., *reprinted in* 1974 U.S.Code Cong. & Admin. News 4670, 4676.

In furtherance of these purposes, ERISA makes certain persons[19] fiduciaries with respect to an employee benefit plan,

[19] "The term 'person' means an individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization." 29 U.S.C. § 1002(9).

and then holds them to fiduciary obligations. ERISA's fiduciary section provides that:

> (1) . . . [A] fiduciary shall discharge his duties with respect to a plan solely in the interests of the participants and beneficiaries and—
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
>
> (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
>
> (D) in accordance with the documents and instruments governing the plan. . . .

29 U.S.C. § 1104(a); *see Berlin v. Michigan Bell Tel. Co.*, 858 F.2d 1154, 1162 (6th Cir.1988) (citing *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir.), *cert. denied*, 459 U.S. 1069, 103 S.Ct. 488, 74 L.Ed.2d 631 (1982)); *see also* Joint Explanatory Statement of the Committee of Conference, H.R.Rep. No. 93-1280, 93d Cong., 2d Sess., *reprinted in* 1974 U.S.Code Cong. & Admin. News 5038, 5075-5106 [hereinafter *Conference Report*].

ERISA defines a fiduciary as follows:

> [A] person is a fiduciary with respect to a plan to the extent . . . he . . . exercises any authority or control respecting management or disposition of its assets. . . .

29 U.S.C. § 1002(21)(A)(i).[20] Whether Hancock is a fiduciary with respect to the Sperry Trust thus depends on the following questions: First, what are the "assets" of the plan? Second, to what extent does Hancock "exercise ... authority or control respecting [their] management or disposition"?

ERISA's general definitional section does not include the phrase "plan assets." At the same time, however, the fiduciary section itself provides for certain exceptions from its coverage. The exception relevant here provides as follows:

For purposes of this part:

. . . . .

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be

[20] In its entirety, the fiduciary definition provides:

(A) Except as otherwise provided in subparagraph (B) [which deals with securities issued by companies registered under the Investment Company Act of 1940], a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A). ERISA further requires that

Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.

29 U.S.C. § 1102(a)(1). The written instrument establishing the Sperry Trust names the Sperry Retirement Committee as fiduciary of the plan; the SRC's duties—management and administration of the trust—are now carried out by the Pension Investment Review Committee of Unisys Corporation. Harris Trust does not appear to argue that fiduciary status should attach to Hancock by virtue of any of the definitions set out in the first clause of subpart (i) or in subparts (ii) or (iii) of 29 U.S.C. § 1002(21)(A).

deemed to include any assets of such insurer. For purposes of this paragraph:

. . . . .

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. . . .

29 U.S.C. § 1101(b)(2)(B).

Hancock argues that in GAC 50 the Sperry Trust has been issued a "guaranteed benefit policy," and that this asset of the plan is the contract embodying the policy, GAC 50, and the corpus of rights that the contract contains.[21] Harris Trust argues that GAC 50 is an investment contract, not an insurance contract; and that even if GAC 50 is an insurance contract, it does not "provide[ ] for benefits the amount of which is guaranteed." Therefore, Harris Trust concludes, GAC 50 is not a guaranteed benefit policy, and the plan's assets here must accordingly include the funds contained in the PAF.[22] For the following reasons, this Court agrees with Hancock that GAC 50 comes under the protection of the "guaranteed benefit policy" exception.

According to Harris Trust, GAC 50 is an investment contract, not an insurance contract. In support of its argument Harris Trust cites *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967), and *SEC v. Variable*

[21] Hancock's position is set out for the most part in Goldberg & Altman, "The Case for the Nonapplication of ERISA to Insurers' General Account Assets," 21 *Tort & Ins. L.J.* 475 (1986). (The authors are members of the Fiduciary Task Force of the American Council of Life Insurance.)

[22] Hancock argues that the funds associated with GAC 50 are not "assets" at all, but a "bookkeeping account." This distinction, which lacks support in precedent and which contradicts some of Hancock's own descriptions of the contract, may be more of metaphysical than of legal significance.

Annuity Life Insurance Co., 359 U.S. 65, 79 S.Ct. 618, 3 L.Ed.2d 640 (1959) ("*Valic*"). Neither case supports such a conclusion.[23]

In *Valic*, the Supreme Court faced the question of whether a variable annuity was a "insurance contract" within the meaning of the McCarran-Ferguson Act and the federal securities acts. The Court decided that it was a "security." Justice Douglas first noted that "the meaning of 'insurance' or 'annuity' under these Federal Acts is a federal question," not a question of state law. 359 U.S. at 69, 79 S.Ct. at 620-21. He then explained how variable annuities differ from fixed ones.

> First, premiums collected are invested to a greater degree in common stocks and other equities. Second, benefit payments vary with the success of the investment policy. . . . The holder of a variable annuity cannot look forward to fixed monthly or yearly amount in his advancing years. It may be greater or less, depending on the wisdom of the investment policy. . . .
>
> The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. The holder gets only a *pro rata* share of what the portfolio of equity interests reflects—which may be a lot, a little, or nothing. . . . [W]e conclude that the concept of "insurance" involves some investment risk-taking on the part of the company. . . . For in common understanding "insurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts.

Id. at 69-71, 79 S.Ct. at 621-22 (footnotes and citations omitted).

[23] Actually, both *Valic* and *United Benefit* pre-dated ERISA, and both addressed the scope of the insurance exception to the federal securities laws, not the guaranteed benefit exception to ERISA. *Cf. United Benefit*, 387 U.S. at 212, 87 S.Ct. at 1562-63. Thus, neither case is directly on point.

The Court's analysis in *United Benefit* was similar. As Justice Harlan described the contract at issue, the purchaser of the annuity paid premiums into a separate account, and the insurance company invested the funds for the most part in common stocks. During the contract's "accumulation" phase, "[i]nstead of promising to the policyholder an accumulation to a fixed amount of savings at interest, the insurer promises to serve as an investment agency and allow the policyholder to share in its investment experience. The insurer is obligated to produce no more than the guaranteed minimum at maturity, and this amount is substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract." 387 U.S. at 208, 87 S.Ct. at 1560. Before the contract's maturity, the purchaser was "entitled to his proportionate share of the total fund and may withdraw all or part of this interest . . . [and] is also entitled to an alternative cash value measured by a percentage of his net premiums which gradually increases. . . . At maturity, the purchaser may elect to receive the cash value of his policy, measured either by his interest in the fund or by the net premium guarantee, whichever is larger." *Id.* at 204, 87 S.Ct. at 1559. Like a variable annuity, therefore, the deferred, or optional, annuity in *United Benefit* "allow[ed] the purchaser to reap the benefits of a professional investment program." *Id.* at 204, 87 S.Ct. at 1558. The fund did not fall within the insurance exemption to the securities laws because it was "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management." *Id.* at 211, 87 S.Ct. at 1562; *see also Peoria Union Stock Yards Co. Retirement Plan. v. Penn Mutual Life Ins. Co.*, 698 F.2d 320, 324-25, 326-27 (7th Cir. 1983); *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1130-34 (7th Cir.1986); *cf. Spirt v. Teachers Ins. & Annuity Ass'n*, 691 F.2d 1054, 1064 (2d Cir.1982).

As the agreed statement of facts reveals, GAC 50 is a retrospective immediate participation guarantee contract. An IPG contract works as follows:

> [IPG] contracts are similar to deposit administration contracts in that the employer's contributions are

placed in an unallocated fund and the life insurance company guarantees that the annuities for retired employees will be paid in full. They differ from deposit administration contracts in the extent to which, and the time at which, the insurance company assumes mortality, investment, and expense risks with respect to retired lives. The IPG contract may be said to have two stages of existence. The first or active stage continues for as long as the employer makes contributions sufficient to keep the amount in the fund above the amount required to meet the life insurance company's price to provide guaranteed annuities for employees who have retired. The contract enters its second stage if the amount in the fund falls to the so-called critical level.

In the active stage, the contract fund is charged directly with the contract's share of the life insurance company's expense[s] and credited directly with its share of investment income (minus a small risk charge). The fund is also credited or charged directly with contract's share of the company's capital gains and losses and the investment and expense experience with respect to retired employees. If the employer allows the fund to fall to the critical level and the contract enters the second stage, the amount in the fund is used to establish fully guaranteed annuities, and the fund itself ceases to exist.

Under an IPG contract, as long as the employer's contributions are sufficient to maintain the contract in active status, the life insurance company is relieved of investment, mortality, and expense risks with respect to all employees, both active and retired. If and when the contract enters the second stage, all these risks will be assumed by the insurance company. *Of course, the company is under a substantial risk during the active status of the contract, since it has provided a guaranteed price structure that the employer can unilaterally decide to take advantage*

of at any time that it feels the probable future course of investment, mortality, and expense risks will be such that it will be to its advantage to shift the risk to the life insurance company.

K. Black & H. Skipper, *Life Insurance* 496-97 (11th ed.1987) (emphasis added).[24] A retrospective IPG contract differs from a newly issued IPG contract in that it assumes responsibility for the guarantees already existing under the previous contractual regime.

Thus, unlike the contracts that governed the plans at issue in *Valic* and *United Benefit*, GAC 50 places the insurance risks on the insurer, not on the plan's covered employees. Nor does GAC 50 have an "accumulation" phase in which the amount available to the *beneficiary*, as opposed to the contractholder, might fluctuate, as it did in *United Benefit*.[25] Whatever the investment

[24] Professors Black and Skipper note further that "[r]ecently, some IPG contracts have been modified, eliminating the guaranteed annuity rates; rather, they provide a certificate stating that the nonguaranteed payments will be made until the fund is exhausted. Under this arrangement the employer is responsible for the adequacy of the funding, and employees have no assurance from the life insurance company that their benefit payments will continue until death." *Id.* at 497.

[25] In *Peoria*, the Seventh Circuit found that the deposit administration contract at issue was an insurance contract during its annuity phase, but an investment contract during its accumulation phase, even though, "unlike [in] *United Benefit*, the annuitant himself—the employee—does not bear, at least directly, the investment risk created by the contract. His benefits are fixed; that is the essence of a defined benefits plan." 698 F.2d at 325. This extension of *United Benefit* ignores the fact that Congress expressly enacted ERISA to protect *employees*, not employers. *See* 29 U.S.C. § 1001(b); *Massachusetts v. Morash*, ___ U.S. ___, 109 S.Ct. 1668, 1671, 104 L.Ed.2d 98 (1989). *Peoria's* holding as to the contract's exemption from the securities laws should not require the same result as to ERISA. If the *covered employee's* retirement benefits are determined by years of service and salary, etc., and are not subject to variation based on investment performance during the accumulation phase, the investment effects on the employer do not make the contract any less an insurance contract as to the covered employee within the meaning of the guaranteed benefit policy exception. *Cf.* 698 F.2d at 328 (noting that on application for rehearing, newly hired counsel for the appellee offered "a number of arguments and authorities that ... original counsel had not drawn to the attention of the court, [and that] [i]n view of the fact that the panel decision merely reverses the dismissal of the complaint under Fed.R.Civ.P. 12 (b)(6), the case is at an early stage and the appellee will have ample opportunity to present its [new] arguments ... consistently with the flexible contours of the doctrine of the law of the case").

experience of Hancock's general account, as credited to the PAF, the covered employees receive a fixed amount determinable by reference to the terms of the plan and not by investment performance. *See* A.S.F. ¶¶ 10, 32, 42; GAC 50 art. II, § 2(F); *id.* art. V, § 1. This amount provided to the covered employees remains fixed even if the PAF falls below the minimum operating level and the contract reverts to a deferred annuity type. In other words, if Hancock's general account experiences negative investment results, it must still pay the covered employees the amounts to which they are entitled.

Harris Trust argues that Hancock's "risk" is illusory, since the LOF purchase rates for the contract contain interest assumptions of two and half and three percent, which Harris Trust calls "outmoded," thus maintaining the PAF at a higher level than it would be if the interest rates were revalued. Furthermore, Harris Trust argues that the possibility of a reversion of the contract is remote. As Harris Trust reads *Valic* and *United Benefit*, the Supreme Court was concerned with the amount of risk that the insurer assumed; since, according to Harris Trust, Hancock bears little risk at all. GAC 50 cannot be a contract of insurance. That argument, however, misconstrues the two cases: they were concerned with the *transfer* of risk from insured to insurer, not simply the nature of the risk the insurer might bear. Harris Trust's argument also minimizes certain of the substantial risks that Hancock does bear, and ignores certain others.

Hancock bears risks under GAC 50 in the following ways, among others:

- It guarantees benefit payments to pre-1968 covered employees and their beneficiaries in fixed amounts, regardless of any increases in life expectancy tables and regardless of the investment experience of Hancock's general account and its corresponding credit to the PAF. A.S.F. ¶¶ 10, 32, 42; GAC 50 art. II, § 2(F); *id.* art. V, § 1.
- It guarantees that post-1968 eligible employees will receive fixed payments on retirement, so long as the PAF is at least equal to the LOF at the time they become vested. A.S.F. ¶ 39.

- It guarantees that on any date the PAF will not fall below the amount that it would have been if the sum of the net interest earned and capital gains and losses apportioned to it had always been zero from the date of its conversion in 1968. A.S.F. ¶ 27; *see* GAC 50 art. III, § 3.
- It guarantees that the "risk charges" applicable to GAC 50 are capped at one percent. A.S.F. ¶¶ 43, 114.

Each of those facts obliges Hancock to bear risks.[34] For example, if Hancock's general account suffered adverse investment results, the PAF would fall below the level of the LOF. Hancock could request additional contributions from Harris Trust, but Harris Trust would be free to decline. GAC 50 would then revert to deferred annuity form, and Hancock would be obliged to provide annuities to all covered employees in consideration of the benefits guaranteed to those employees up to that time. Hancock would lose a sum of money equal to the amount by which the annuity payments to covered employees exceeded the premiums it had received plus the investment gains attributed to those premiums. Furthermore, the covered employees and their beneficiaries might outlive their assumed life expectancies, and under its guarantee Hancock would have to pay benefits

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[34] *See generally* K. Black & H. Skipper, *supra*, at 494:

> Life insurance companies are in the business of accepting risks, so they are willing to underwrite several different risks associated with pension plans and to underwrite them to varying degrees, depending on the employer's wishes. Some of these are as follows:
>
> 1. More individuals may live to retire than the mortality tables used anticipated.
>
> 2. Those who retire may live longer than the mortality tables used anticipated.
>
> 3. The rate of interest earned on investments may fall below the anticipated level.
>
> 4. There may be defaults in the investment portfolio, or it may necessary to sell particular investments at a loss.
>
> 5. Expenses of handling the play may be higher than anticipated.

for longer than it had calculated. Neither scenario was manifestly implausible in 1968. Hancock also guarantees that the rate tables under the contract will be applicable to both newly eligible employees or additional groups of employees, should Harris Trust so desire. Although interest rates have increased since 1968, they have been known to revert to their previous levels or lower, and, in that event, Hancock would still be obliged to guarantee those additional benefits. Given the possibility of a stock market crash, moreover, Hancock's guarantee of the principal of the PAF also constitutes the assumption of risk. These risks are not illusory, and were not illusory in 1968, when GAC 50 was amended. Indeed, Hancock's transfer in November, 1988 of approximately $53 million from the PAF to Harris Trust reduced the PAF to a level at which the contract's reversion to deferred annuity form may be triggered more readily. In sum, Harris Trust seems to be arguing that in hindsight, it does not like the bargain that it once struck. That argument should not change the terms of its contract, provided the covered employees are not prejudiced.

As noted above, ERISA defines a "guaranteed benefit policy" as "an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b). The above interpretation of the statutory provision's language is supported by its legislative history. The conference committee report explained:

> An insurance company also is not considered to hold plan assets if a plan purchases an insurance policy from it, to the extent that the policy provides payments guaranteed by the company. If the policy guarantees basic payments but other payments may vary with, *e.g.*, investment performance, then the variable part of the policy and the assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.

Conference Report, supra, at 5077. This commentary (which is the sole passage in the legislative history that deals with the

guaranteed benefit policy exception) confirms that while Congress did intend ERISA's fiduciary sections to cover variable annuity contracts, Congress did not intend to hold an insurer to a fiduciary standard if the contract it issues provides for fixed payments to the plan beneficiary.

Harris Trust interprets the conference report differently. It argues that the guaranteed benefit policy exception does not cover policies in which payments to the *contractholder* might fluctuate, and that since the funds in the PAF cannot be divided into those that support payments that are guaranteed and others that not guaranteed, the entire PAF must not be covered by the exemption at all.[27] Yet Harris Trust's argument rests on a misinterpretation of the word "benefit" in the statute and of the word "payment" in the conference report. ERISA was enacted to protect the interests of pension plan participants, that is, of employees, and not the fiscal wellbeing of their employers.[28] Each time ERISA uses the word "benefit," it refers to the payments made to the employees themselves. *See, e.g.*, 29 U.S.C. § 1002(7) (" 'participant' means any employee . . . who is or may become eligible to receive a benefit of any type from an employee benefit plan"); *id.* § 1002(8) (" 'beneficiary' means a person designated by a participant . . . who is or may become entitled to a benefit"); *id.* §§ 1023(e), 1054, 1056, 1104(a)(1)(A)(i), 1108(c)(1). The word "benefit" in the guaranteed benefit policy exception, and the word "payment" in the conference report,

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[27] As a fallback position, Harris Trust argues the opposite—that Hancock should be deemed a fiduciary with respect to the sum of money in the PAF that exceeds the sum of the MOL (an amount Harris Trust refers to as "free money"). As Hancock notes, however, Harris Trust does not explain how such a bifurcation might work in practice. More significantly, given the Court's holding that a plan's "assets" do not include those funds held in an insurer's general account, the difference between the PAF and MOL is of no legal bearing. *See also American Inst. of Architects Benefit Ins. Trust v. John Hancock Mut. Life Ins. Co.*, No. CV 86-08436 (C.D. Cal. Sept. 14, 1987), *aff'd mem.*, 857 F.2d 1477 (9th Cir.1988).

[28] This Court is aware of employers terminating plans that are overfunded to provide funds for leveraged buyout obligations or other corporate purposes. (In some such cases, employees' pension benefits may remain secure but their employment status is sometimes affected.)

are no different; they too refer to benefits and payments to covered employees. Because GAC 50 provides for fixed payments to covered employees, it is covered by the guaranteed benefit policy exception.

Pronouncements by the Department of Labor, the administrative agency charged with ERISA's enforcement, *see* 29 U.S.C. § 1135, support the same conclusion. ERISA Interpretive Bulletin 75-2 provides as follows:

> (b) *Contracts or policies of insurance.* If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets. Therefore, a subsequent transaction involving the general asset account between a party in interest and the insurance company will not, solely because the plan has been issued such a contract or policy of insurance, be a prohibited transaction.

29 C.F.R. § 2509.75-2 (1988). In hearings before a subcommittee of the House of Representatives, Assistant Secretary of Labor for Labor Management Relations Paul J. Fasser explained:

> Let's take a large multiemployer plan, having several thousand contributing employers, the benefits of which are wholly insured but not fully guaranteed. The insurance company invests the premiums it receives from the plan along with premiums received from other policyholders, in a wide variety of ways: corporate and government bonds, real estate mortgages, other secured loans, and some equities, to mention a few. Section 401(b) [29 U.S.C. § 1101(b)] could be read to mean that the insurance company could not invest its premium receipts in bonds or equity securities issued by any of the employers contributing to the policyholder plan, [that] it could not allow any of these employers to lease space in a building on which it held a mortgage, and [that] it could not purchase goods, services, or facilities from any one of those employers.
>
> . . . We studied the law and the underlying rationale of the prohibited transactions provisions, we studied the legislative history, we conferred with our colleagues at the Internal Revenue Service, we applied our collective common sense, and we concluded that Congress did not intend this result. We recognized that the prohibited transactions restrictions are designed to avoid conflicts of interest situations, but we knew that where the premiums paid by a plan are placed in an insurance company's general asset account, along with the assets of many other plans, the risk of any one plan being able to influence the investment policy of the insurance company respecting the general asset account is extremely slight.
>
> So we exercised our authority to interpret the law and we published an interpretive bulletin . . . stating that the mere investment of plan assets by a plan in a corporate entity or partnership does not convert the assets of the corporation or partnership into plan assets and does not make the managers of the corporation or partnership fiduciaries to the plan. Those managers are thus not restricted from engaging in normal business transactions, including transactions with persons who happen to be parties in interest with respect to the policyholder plans.

Oversight on ERISA: Hearings on Public Law No. 93-406 Before the Subcommittee on Labor Standards of the House Committee on Education and Labor, 94th Cong., 1st Sess. 390-91 (1975), *quoted in Jacobson*, *supra*, 662 F.Supp. at 1109-10 (and *reprinted in* Goldberg & Altman, "The Case for the Nonapplication of ERISA to Insurers' General Account Assets," 21 *Tort & Ins. L.J.* 475, 485-86 (1986)). This logic applies with equal force to single employer plans.

Harris Trust argues that other, later Department of Labor commentary contradicts Interpretive Bulletin 75-2. Harris Trust relies on Department of Labor Advisory Opinion 83-51A (Sept. 21, 1983) and on Department of Labor Advisory Opinion 78-8A (Mar. 13, 1978). Advisory Opinion 83-51A does seem to support Harris Trust's position. It includes the following comment:

> In the Department's view, a separate account would not hold "plan assets" for the purposes of the fiduciary responsibility provisions of ERISA if it is maintained by an insurance company solely in connection with its fixed contractual obligations and if neither the amount payable (or credited to) the plan or to any participant or beneficiary of the plan (including an annuitant) is affected in any way by the investment performance of the separate account. Since it appears that the contracts described in your letter provide for fixed obligations of the insurance company and that the investment performance of the separate accounts do not, in any circumstances, affect the insurance company's obligations to either the plan to which the contract is issued or to its participants and beneficiaries, such separate accounts would therefore not be considered to hold "plan assets."

Advisory Opinion 83-51A, at 2. As advisory opinions, however, the letters "apply only to the situation described therein. Only the parties described in the request for opinion may rely on the opinion, and they may rely on the opinion only to the extent that the request fully and accurately contains all the material facts and representations necessary to issuance of the opinion and their situation conforms to the situation described in the request for opinion." ERISA Procedure 76-1, § 10, 41 Fed.Reg. 36,281 (Aug. 27, 1976); *see* Advisory Opinion 83-51A, at 2 ("This letter constitutes an advisory opinion under ERISA Procedure 76-1. . . . Accordingly, it is issued subject to the provisions of the procedure, including section 10 thereof relating to the effect of advisory opinions."). Furthermore, both opinion letters address a question relating to funds held in *separate*, not general, accounts. *See* Advisory Opinion 78-8A, at 2 ("Although CREF labels its account a 'general' account, it is the view of the Department of Labor . . . that the assets in the account which support obligations under variable annuity contracts issued to pension plans are plan assets. . . . The annuity contracts issued by CREF provide for variable benefits; generally assets supporting obligations under these contracts are held in a separate account.").

The opinion letters are therefore of no precedential significance. Instead, the Department of Labor has later confirmed the interpretation it set out in Interpretive Bulletin 75-2. *See Proposed Final Regulation Relating to the Definition of Plan Assets*, 51 Fed.Reg. 41,262 (Nov. 13, 1986); 50 Fed.Reg. 961 (Jan. 8, 1985). Because the Department of Labor's interpretation of the guaranteed benefit policy exception is manifestly "permissible," this Court "may not substitute its own construction." *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843, 844, 104 S.Ct. 2778, 2782-83, 81 L.Ed.2d 694 (1984). Accordingly, this Court holds that the assets held in Hancock's general account are not "plan assets" within the meaning of ERISA's fiduciary sections.

As the guaranteed benefit policy exception itself provides, because GAC 50 is a guaranteed benefit policy, the assets of the plan "shall be deemed to include such policy" – that is, GAC 50 and the bundle of contractual rights that flow from it. With respect to the policy, only the contractholder, not the insurer, is to be held to fiduciary standards. This conclusion finds support in ERISA's legislative history. Referring to the insurance contract exception to the requirement that "all plan assets are to be held in trust," 29 U.S.C. § 1103(b)(1), the Committee on Conference stated:

> A trust is not to be required in the case of plan assets which consist of insurance (including annuity) contracts or policies issued by an insurance company qualified to do business in a State (or the District of Columbia). . . . Although these contracts need not be held in trust, nevertheless, the person who holds the contract is to be a fiduciary and is to act in accordance with the fiduciary rules . . . with respect to these contracts. For example, this person is to prudently take and keep exclusive control of the contracts, and is to use prudent care and skill to preserve this property.

Conference Report, *supra*, at 5079. A contrary interpretation would lead to absurd results. As Harris Trust notes, for example,

GAC 50 gives Hancock the authority to "ascertain and apportion any divisible surplus accruing under contracts of this class," GAC 50 art. V, § 7; *see* A.S.F. ¶ 28. Yet Hancock sets dividend rates for *all* its participating group annuity contracts, pursuant to the requirements of state law. It would impossible for Hancock to comply with ERISA's requirement that it act "solely in the interest" of the participants and beneficiaries of the Sperry Trust without simultaneously breaching its duties to all its other customers. Congress could not have intended such an outcome.[29]

CONCLUSION

In conclusion, this Court holds that John Hancock is not a fiduciary with respect to the Sperry Rand Master Retirement Trust No. 2. Accordingly, the defendant's motion for partial summary judgment is granted, and the plaintiff's motion for partial summary judgment is denied. The first count of the plaintiff's amended complaint is hereby dismissed.

IT IS SO ORDERED.

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[29] Harris Trust argues that the asset of the plan is the policy itself, that Hancock "exercises authority or control respecting management or disposition" of the policy. 29 U.S.C. § 1002(21)(A)(i), and that with respect to the policy Hancock must therefore abide by the fiduciary requirements. Harris Trust bases its argument on two cases, *Chicago Board Options Exchange, Inc. v. Connecticut General Life Insurance Co.*, 713 F.2d 254 (7th Cir.1983), and *Ed Miniat, Inc. v. Globe Life Insurance Group, Inc.*, 805 F.2d 732 (7th Cir.1986); *see also F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir.1987). As Hancock points out, however, both *Chicago Board* and *Ed Miniat* involved contracts that gave the insurer the unilateral right to amend terms to the detriment of the trustee. *See* Memorandum of Defendant in Opposition to Plaintiff's Motion for Partial Summary Judgment at 74-79. GAC 50 does not confer any similar discretion.

Opinion and Order of the
District Court
July 12, 1991,
as amended August 6, 1991

Harris Trust & Sav. Bank v.
John Hancock Mut. Life Ins. Co.,
767 F. Supp. 1269 (S.D.N.Y. 1991)

HARRIS TRUST AND SAVINGS BANK, as Trustee of the Sperry Master Retirement Trust No. 2, Plaintiff,

v.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY, Defendant.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY, Third-Party Plaintiff,

v.

CHASE MANHATTAN BANK, N.A., Counterclaim Defendant,

and

Sperry Corporation and the Retirement Committee of Sperry Corporation, Third-Party Defendants.

No. 83 Civ. 5401 (RPP).

United States District Court, S.D. New York.

July 12, 1991.

As Amended Aug. 6, 1991.

OPINION AND ORDER

ROBERT P. PATTERSON, Jr., District Judge.

Defendant John Hancock Mutual Life Insurance Company ("Hancock") moves pursuant to Rule 56 of the Federal Rules of Civil Procedure and the Agreed Statement of Facts stipulated by the parties on November 23, 1988 (hereinafter "A.S.F. ¶ ___")

to dismiss the remaining claims of plaintiff's amended complaint. By its opinion and order dated September 26, 1989, this Court dismissed plaintiff's claim asserted under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, et seq. ("ERISA"). This motion relates to plaintiff's contract and common law claims.

The claims in this action arise out of or relate to Group Annuity Contract No. 50 ("GAC 50"), which was first entered into in 1941 by the defendant and Sperry Corporation ("Sperry") and covered non-bargaining unit employees of Sperry Gyroscope, Sperry Division.[1] A.S.F. ¶ 5. Hirschberg Tr. 18. Pursuant to GAC 50's original terms, Sperry purchased on an annual installment payments basis deferred annuities from Hancock payable for life to Sperry employees or their beneficiaries to the extent that the employees and beneficiaries would be entitled to such a payment upon the employees' retirement, according to the terms of Sperry's retirement plan. A.S.F. ¶ 6. In other words, once a covered employee's benefits vested under the plan, Hancock would guarantee those benefits. *Id.* ¶ 10. By agreement between the parties, GAC 50 has undergone substantial changes since 1941. Most relevant to this motion are those that occurred in 1968 and 1977.[2]

Effective January 1, 1968 GAC 50 was converted by amendment from a deferred annuity form of participating contract under which Sperry purchased deferred annuities from Hancock on an annual basis for the non-bargaining unit of the Sperry Gyroscope Division to a Retrospective Immediate Participation Guarantee form ("Retro-IPG") under which it guaranteed benefits for each eligible employee under GAC 50 for that employee who was also eligible under the terms of the Sperry Rand Retirement Trust No. 2 (the "Plan" or the "Sperry Trust"). A.S.F. ¶ 23.

[1] The factual background of this litigation is contained in large part in this Court's opinion of September 26, 1989, 722 F.Supp. 998. GAC-1150 covered the bargaining unit employees of the Sperry Gyroscope, Sperry Division.

[2] In 1968 Sperry determined to modify its method of funding employee pensions so that future retirees would not be provided guaranteed pension benefits from an insurance company but would look to investments of the Sperry retirement account to pay pension benefits. (Hirschberg Tr. 16, 78, 94).

Hancock IPG contracts are participating contracts in that the purchaser shares in the aggregate of the contract's mortality, expense and investment experience to the extent that that experience is more favorable than the experience assumed in the contract's purchase rates. *Id.* ¶ 11. Net investment income from Hancock's General Account allocated to an IPG contract is directly credited on an annual basis to that contract's Pension Administration Fund ("PAF").[3] The amount of the PAF depends in part on the investment performance of Hancock's General Account and the allocation of that performance to the IPG.[4]

Pursuant to the 1968 amendment, annuities purchased for certain employees up to December 31, 1967 were "cancelled," but Hancock continued to guarantee benefits to those employees and their beneficiaries. A.S.F. ¶ 32. The 1968 amendment also established a method for the provision of additional guaranteed benefits to be payable for the period after December 31, 1967 as more fully described in this Court's earlier opinion. In essence, if GAC 50's PAF exceeded its Minimum Operating Level ("MOL"), which was equal to 105% of the Liabilities of the Fund ("LOF"), Hancock would guarantee the payment of the additional guaranteed retirement benefits to those employees.[5] *Id.* ¶ 39.

[3] The deferred annuity form of contract had ultimately distributed such net experience to the contract holder as dividends. A.S.F. ¶¶ 17, 19. For purposes of this opinion "PAF" shall also include the Contingency Account which was part of the General Account (GAC 50, Article I, Section 18) since the parties' arguments do not rely on any distinction of consequence between the Contingency Account and the PAF.

[4] Under the 1968 amendment, Hancock guarantees that the PAF on any date will not be less than it otherwise would have been if the sum of the net interest earned and capital gains and losses apportioned to the PAF had always been zero from January 1, 1968. A.S.F. ¶ 27.

[5] If GAC 50's PAF balance fell below the amount of the LOF (or the amount of the PAF and Sperry's supplemental fund balances together fell below the amount of the MOL), Hancock could ask Sperry for a contribution. If the PAF balance was not at least equal to the LOF or if the GAC 50's PAF and supplemental fund were not equal to the MOL, the PAF would terminate and the contract would function thereafter as a deferred annuity contract pursuant to which Hancock had to provide annuities for all guaranteed benefits. A.S.F. ¶¶ 36, 40, 42.

Effective August 1, 1977 GAC 50 was converted to a Retrospective Immediate Participation Guarantee/Prospective Deferred Liability form of contract ("Retro-IPG-PDL") under which the employees retiring thereafter received some benefits guaranteed by Hancock and relied on Plan assets for the remainder. Under the 1977 amendment GAC 50's LOF would not be increased automatically upon the subsequent retirement of any employee and new retirement benefits would not be guaranteed automatically by Hancock. A.S.F. ¶ 80. The Sperry Retirement Committee ("SRC") could request that Hancock establish guaranteed benefits in addition to the benefits already guaranteed, but it did not do so. *Id.* ¶ 81. The 1977 amendment also permitted Sperry to designate employees eligible for non-guaranteed benefits and provided for the payment of such benefits by Hancock from the PAF or its Contingency Account within Hancock's General Account. Although the Sperry Retirement Committee did not request Hancock to pay any new guaranteed benefits subsequent to the effective date of the 1977 amendments, the Committee did designate that monthly payments of non-guaranteed benefits be paid to certain employees in 1977 and Hancock paid such non-guaranteed benefits through June 1982, when it gave Sperry 31 days notice in writing that it would no longer pay non-guaranteed benefits.

Hancock contends that it at all times fully performed its obligations under GAC 50 and its amendments and is entitled to summary judgment dismissing plaintiff's breach of contract claims. It further claims that plaintiff's claims for breach of fiduciary duty and for breach of an implied covenant of good faith and fair dealing must also be dismissed since all obligations of Hancock to the plaintiff arise solely from and are defined by the provisions of GAC 50.[*]

[*] On July 29, 1988, the parties submitted a proposed joint pretrial order to Judge Cedarbaum in which plaintiff's claims were identified as ERISA claims and common law claims. At a conference on September 16, 1988, Judge Cedarbaum authorized bifurcated motions for summary judgment along those lines. The ERISA motion has been decided. This motion is intended to dispose of the action.

I. *Contract Claims*

Where the language of a contract is unambiguous the question of interpretation is one of law to be answered by the court without reference to extrinsic evidence. *See Rothenberg v. Lincoln Farm Camp, Inc.*, 755 F.2d 1017, 1019 (2d Cir. 1985). If the language of a contract is otherwise plain, the parties cannot create a genuine issue of material fact simply by urging different interpretations. *See Hunt Ltd. v. Lifschultz Fast Freight, Inc.*, 889 F.2d 1274, 1277 (2d Cir.1989).

1. Did Hancock Improperly Retain Excess Funds Allocated to GAC 50?

In or about May 1982 Hancock denied a request from the Sperry Retirement Committee for a transfer of assets under what the parties had come to refer to as a "rollover procedure." Hearing Exh. 2.

It is necessary to refer to the history of GAC 50 to understand the reason for the dispute.

Prior to 1968, the Sperry Retirement Committee did not manage pension funds for its employees. At the time of the 1968 Amendment, the Committee took on a number of investment managers to manage various funds for the Plan to provide retirement benefits for its employees upon retirement. (Hirschberg Tr. 13-14) Starting in 1968, Hancock, in addition to providing guaranteed benefits under GAC 50 and similar annuity contracts, received responsibility from Sperry to manage for the Plan a smaller separate account, an equity investment account. (Hirschberg Tr. 14) Funds in the separate account, like the funds distributed to other investment managers retained by the Retirement Committee, did not provide guaranteed benefits and were assets of the Plan. (*Id.*) By 1977 it became evident to Hirschberg that the other fund managers were providing the Retirement Fund with a better rate of return than Hancock's General Account and he determined that the cost of the benefits guarantee provided by Hancock was excessive. Accordingly, Sperry's Retirement Committee desired to remove funds from Hancock's General Account and place them in other funds over which it could exercise more investment control. (Hirschberg Tr. 11, 15)

By the 1977 amendment, an employee who retired after 1977 had those benefits which had accrued prior to 1968 guaranteed by Hancock and those non-guaranteed benefits which accrued thereafter were funded only by the Plan's assets.[7] The Committee wanted to move so-called "excess funds" out of Hancock's General Account. It was in this context that Hirschberg explored ways with Hancock as to how a removal of excess funds might be achieved without incurring the contract's Asset Liquidation Adjustment ("ALA"). As an example, in 1977 the GAC 50 had an excess of funds in the General Account, whereas the GAC-1150, another Sperry guaranteed benefit contract, required a transfer of funds into its pension administration fund in the General Account to satisfy its annuity funding requirements. The Committee did not want to liquidate its equity portfolios in the separate accounts at Hancock to meet GAC-1150's shortfall. (*Id.* at 19) To meet this problem, so-called "excess funds" in GAC 50 were transferred by agreement of the parties to the separate accounts and then to GAC-1150 for its pension administration fund in the General Account. Hearing Exhs. L, T.[8] The net effect was to leave the balance of the General Account unchanged and no asset liquidation charge was imposed.

Hirschberg continued at meetings between representatives of both companies to press for the reduction of funds in GAC 50's General Account. Thereafter in 1979 and 1981 Hancock permitted the Committee pursuant to so-called "rollover arrangements" to withdraw certain amounts of "excess" funds from the PAF without the ALA required under GAC 50. Hearing

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[7] An employee covered by GAC-50 who retired prior to 1977 had all his or her benefits guaranteed by Hancock. One of the Committee's purposes in effecting the change was to stop the growth of guaranteed benefits (Hirschberg Tr. 17) and increase the funds under the investment control of the Committee.

The 1977 amendment required Hancock to issue newly-worded certificates to retiring employees. Jefferson Tr. at 22.

[8] The excess funds were evidently transferred by Hancock's waiver of one of the requirements of the rollover transfer for direct-rated participating IPG contracts. Exh. 10, Pl.Exh. Binder.

Exhs. 4, 5, 11; Jefferson Tr. 46; Hirschberg Tr. 50. Hancock acknowledges it had a "rollover" policy which it offered to General Account customers whose balance of funds in that account exceeded liabilities by 20 percent and some other criteria, whereby the excess of cash inflow over cash outflow, plus 4% of the beginning fund balance of a PAF, could be transferred out of the General Account.[9] A.S.F. ¶ 77. In 1979 a rollover was offered to Hirschberg and accepted. In 1980 Hancock altered its policy and eliminated rollovers, except for "grandfathered" customers. (Penney Tr. 137) In 1981 Sperry asked for a rollover for 1980 and received it. Subsequently in 1981 Hancock eliminated rollovers for all customers. (*Id.* at 139)

Plaintiff maintains that these rollover withdrawals were by contract amendment pursuant to oral agreement of the parties and that it had a contractual right to such rollovers for every subsequent year. As evidence of that agreement plaintiff relies not on language of the contract or any formal written amendment thereto but on oral understandings which all witnesses for the defendant deny. To support its claim, plaintiff relies on two Hancock internal memoranda, Exhibits 10 and 12, a memorandum dated March 28, 1977 and a memorandum dated December 31, 1981, respectively. Exhs. 10 & 12, Plaintiff's Exhibit Binder Submitted in Opposition to Defendant's Motion to Dismiss filed Mar. 23, 1990 (hereinafter "Pl.Exh. Binder").

Although both these memoranda make reference to rollover arrangements and plaintiff's participation in them, they do not constitute amendments to the contract requiring a continuation of such rollovers.

In the first place, it is highly unlikely that any officer of either company expected a contract of this complexity and involving the

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[9] Due to the guarantee provisions and state insurance laws or regulations, investments carried in the General Account were generally long-term investments, in very large part fixed income securities. After 1959 each year's investments were part of a "cell" carried at book value. A.S.F. ¶ 20. However, although the investments were long term, certain liquidations would occur during a year and those funds less offsets were utilized for rollovers.

amounts in question to be amended orally. Other amendments were made in writing. Furthermore, there are no references to amending the contract in either exhibit. Without such references and without an indication that Hancock was seeking to be bound contractually to permit future rollovers, the Statute of Frauds is not satisfied.

Neither exhibit contains expressly or by reasonable implication all the material terms of the agreement. Nor is there any indication of a continuing obligation with respect to "rollovers."[10] Under these circumstances the exhibits are insufficient proof of an agreement to be bound in futuro under the Statute of Frauds. *See Fort Howard Paper Co. v. William D. Witter, Inc.*, 787 F.2d 784, 791 (2d Cir.1986); *Scheck v. Francis*, 26 N.Y.2d 466, 472, 260 N.E.2d 493, 311 N.Y.S.2d 841 (1970); *Morris Cohon & Co. v. Russell*, 23 N.Y.2d 569, 575, 245 N.E.2d 712, 297 N.Y.S.2d 947 (1969).

Plaintiff argues that partial performance removes the agreement from the Statute of Frauds. Plaintiff points to the 1979 and 1981 "rollovers" as evidence of partial performance of the continuing obligation to provide rollover as satisfaction of Hancock's Statute of Frauds defense. "The doctrine of part performance may be invoked only if plaintiff's actions can be characterized as 'unequivocally referable' to the agreement alleged." *Anostario v. Vicinanzo*, 59 N.Y.2d 662, 663, 450 N.E.2d 215, 463 N.Y.S.2d 409 (1983). *See Tribune Printing Co. v. 263 Ninth Ave. Realty, Inc.*, 88 A.D.2d 877, 878-79, 452 N.Y.S.2d 590 (App.Div. 1st Dep't), *aff'd*, 57 N.Y.2d 1038, 444 N.E.2d 35, 457 N.Y.S.2d 785 (1982). Here plaintiff's requests for withdrawals are explainable as a response to Hancock's alleged notification in August 1979 of the existence of the rollover as a generalized procedure. Pl.Mem. in Opp. at 35. They are not "unequivocally referable" to an amendment of the contract.

[10] It is true that Hancock's Philip Jefferson, in seeking approval by Hirschberg of a proposal to revalue the LOF, indicated that rollover would not be discontinued if the proposal were adopted (Exh. 12 at 3, Pl.Exh. Binder), but this implies that Hirschberg realized at the time there was no right to rollovers under the contract and the writing does not constitute a commitment to continuation of rollovers.

The Court also notes that New York Jurisprudence 2nd states that for the doctrine of partial performance to apply, "[t]he acts of part performance must have been done by the person insisting upon the contract." 61 N.Y.Jur.2d *Statute of Frauds* § 254 at 396 (1987). Here the claimed acts of part performance are by Hancock who disavows any such modification of the contract.

As for plaintiff's argument that promissory estoppel applies, that claim does not lie because plaintiff alleges no acts that were taken by it in reliance on the alleged oral promises of Hancock. *See Republic Nat'l Bank of New York v. Sabet*, 512 F.Supp. 416, 426 (S.D.N.Y.1980), *aff'd*, 681 F.2d 802 (2d Cir.1981), *cert. denied*, 456 U.S. 976, 102 S.Ct. 2241, 72 L.Ed.2d 850 (1982). Accordingly, the Court finds as a matter of law that the Statute of Frauds bars plaintiff's claim to a right to rollover for the years subsequent to 1980.

2. Termination of Non-Guaranteed Benefits

This dispute between the parties centers on the meaning of the 1968 and 1977 amendments and actions relating thereto. Plaintiff claims the failure of Hancock to continue to pay non-guaranteed benefits after June 1982 constitutes a breach of contract.[11]

[11] Because a "guaranteed benefit policy" is exempt from ERISA only "to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer," 29 U.S.C. § 1101(b)(2)(B), it could be argued that funds in GAC 50's PAF devoted to non-guaranteed benefits are subject to ERISA even though they are held in Hancock's General Account. Under 29 U.S.C. § 1101(b)(2)(B)

> (2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph
>
> (B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

(Footnote continued)

A significant event which preceded Hancock's alleged breach occurred in May 1982 when Hancock was notified by the Committee that the Committee had amended the Sperry Plan by expanding it to include retired employees of Sperry's Univac Division within the category of employees entitled to receive non-guaranteed benefits under GAC 50 and was requesting payment of non-guaranteed benefits to such employees.[12] A.S.F. ¶ 84. Hancock at first took the position that the Sperry Plan only contemplated payment of non-guaranteed benefits, such as cost-of-living adjustments, to employees already covered by the Plan (Hirschberg Tr. 41). When Sperry demurred, Hancock took the position that it was entitled to discontinue unilaterally payments of all non-guaranteed benefits under the terms of Article IV, Section 9, paragraph (c) of GAC 50 and gave the Committee 31 days notice in writing that it would terminate all such payments. Exh. 4, Pl.Exh. Binder.

Plaintiff maintains that Hancock was only entitled to give notice of termination of such payments if the amount of the Pension Administration Fund became insufficient to support the making of "Non-Guaranteed Benefit" payments.

The provision relied on by Hancock reads as follows:

Non-guaranteed benefits were paid not from segregated assets or a separate account but from surplus or so-called "excess funds" in GAC 50's PAF. Under the second sentence of subdivision (B), surplus held by an insurer in a separate account is not subject to ERISA because it falls within the "guaranteed benefit policy" exception. There is no reason to deny similar exemption to so-called "excess funds" under GAC 50 even though they are held in Hancock's General Account rather than in a separate account. "ERISA was designed to prevent a fiduciary 'from being put in a position where he has dual loyalties, and, therefore, he cannot act exclusively for the benefit of a plan's participants and beneficiaries.' " *Levy v. Lewis,* 635 F.2d 960, 968 (2d Cir.1980) (citation omitted). If Congress had intended ERISA's fiduciary requirements to apply to surplus held in an insurer's general account, it would have made its intention clear. *See Mack Boring & Parts v. Meeker Sharkey Moffitt,* 930 F.2d 267, 275 n. 17 (3d Cir.1991).

[12] The Univac Division manufactured Sperry's large computers and its employees had not been covered by GAC-50.

SECTION 9. Payment of Non-guaranteed Benefits

Non-guaranteed Benefit payments shall be payable to a payee, provided the Pension Administration Fund is sufficient for the purpose, upon written notice from the Sperry Rand Retirement Committee to the Company. Such notice shall specify the payee's Benefit Commencement Date and the amount, form and manner of such Non-guaranteed Benefit payments. Non-guaranteed Benefit payments shall continue until

(a) the date of death of the payee,

(b) the date as of which the Retirement Committee notifies the Company, in accordance with the next paragraph, that such Non-guaranteed Benefit payments are to be canceled, suspended, or adjusted,

(c) the date as of which the Company, by written notice filed with the Retirement Committee at least thirty-one days prior thereto, declares its intention to cease such payments,

(d) the date the Pension Administration Fund ceases to exist.

The Retirement Committee shall have the right to notify the Company that Non-guaranteed Benefits provided under this Contract shall be canceled, suspended or adjusted on and after the date specified by the Retirement Committee. Such notice must be in writing and be received by the Company at its Home Office prior to the date of cancellation, suspension or adjustment. On and after the date of cancellation or suspension specified in such notice, no further payments shall be made by the Company with respect to the Non-guaranteed Benefits provided for payees included in any cancellation notice or during the period of suspension for payees included in any suspension notice, and the Company shall have no responsibility with respect to any Non-guaranteed Benefits which may be canceled, or if Non-guaranteed Benefits are suspended, during the period of suspension. On and

> after the date of the adjustment specified in such notice, the liability of the Company with respect to the Non-guaranteed Benefits provided for payees included in such notice shall be equal only to the liability for the adjusted Non-guaranteed Benefits provided in such notice for such payees.

GAC 50, 1977 Amendment, Article IV, Section 9.

The Court's reading of the plain meaning of this Section is that, provided the PAF is sufficient for the purpose, Hancock shall initiate non-guaranteed payments to employees designated upon notice from the Committee and shall continue making such payments until (a), (b), (c) or (d) occurs.

Plaintiff argues that the PAF Fund was sufficient to make the payment of the non-guaranteed benefits to the Univac employees at the time of Hancock's termination and that until such date as the PAF was insufficient for that additional purpose, Hancock had an obligation to provide non-guaranteed benefits to the Univac employees. It bases its argument primarily on Article II, Section 3, which reads as follows:

> Section 3. Non-Guaranteed Benefits
>
> The Retirement Committee shall notify the Company in writing of the Benefit Commencement Date of an employee in advance of such date, and shall furnish such other information with respect to the employee or his designated survivor as is necessary to provide the Non-guaranteed Benefit.
>
> The monthly amount of Non-guaranteed Benefit to be provided hereunder for an employee shall be the amount to which he is entitled on such date in accordance with the Plan as determined by the Retirement Committee. The determination of eligibility for and the amount of such Non-guaranteed Benefit shall be made solely by the Retirement Committee and the Company shall have no responsibility for such determination.

> On and after the Benefit Commencement Date of an employee, the Non-guaranteed Benefit for such an employee or his designated survivor shall be payable hereunder in accordance with the Plan until the earliest of the date of his death, the date the Retirement Committee notifies the Company in accordance with Section 9 of Article IV that said Non-guaranteed Benefit payments are to be canceled, suspended or adjusted, or the date the Pension Administration Fund is not sufficient to provide the Non-guaranteed Benefits for the payee.

GAC 50, 1977 Amendment, Article II, Section 3.

Plaintiff also bases its argument on the following language added to Article III, Section 2, by the 1977 Amendment:

> Section 2. Pension Administration Fund
>
> a. The following heading is inserted immediately following the Section title: "A. Applicable to Guaranteed Benefits"
>
> b. The following paragraph and succeeding heading are added immediately following the second paragraph of this Section:
>
> "B. Applicable to Non-guaranteed Benefits
>
> On the Benefit Commencement Date of an employee and on each date thereafter on which a Non-guaranteed Benefit is due with respect to an employee on or before the date of termination of the Fund, a Non-guaranteed Benefit shall be provided hereunder with respect to each employee entitled thereto. The Company shall be liable for any amount of Non-guaranteed Benefit expressed to be payable only to the extent to which the Fund is sufficient to provide such amount.
>
> C. Applicable to Guaranteed and Non-guaranteed Benefits"

GAC 50, 1977 Amendment, Article III, Section 2(B).

Article III is entitled "Contributions" and relates to the method of computing how contributions from Sperry to the Plan were to be calculated. Accordingly, it does not appear to be relevant to Hancock's right to terminate non-guaranteed benefits.

Plaintiff argues that Article II, Section 3, Article III, Section 2, and Article IV, Section 9, can only be read in harmony if they are read as plaintiff suggests and that where two terms of a contract irreconcilably conflict, the first term, i.e., Article II, Section 3, governs. It has also asked the Court to look to extrinsic evidence in the form of an affidavit of its former Vice President, Thomas Hirschberg, who was ultimately responsible for managing the Plan, stating that he believed Hancock had no right to terminate such payments. Reference to such extrinsic evidence is unnecessary because the structure of the contract as testified to by witnesses for both parties makes the meaning of the contractual language clear.

At a hearing held on dates in December 1990 and January 1991 to determine whether there existed a genuine issue of fact on this issue and the rollover issue, it became evident that the history of the GAC 50 contract had a bearing on the constructions the parties were asking the Court to make. In the words of Kenneth Crafts, Sperry's retired employee, who had immediate responsibility for a lengthy period of time for the administration of GAC 50, Article II had originally actually been Sperry's group annuity plan for the covered employees and the retirement benefits to be available for these employees were designated thereunder. In this form, GAC 50 existed as the guaranteed benefit deferred annuity benefit plan for the employees until 1968. (Crafts Tr. 40-41)

Crafts stated that Article II was "the description of how benefits accrue for an employee." (*Id.* 41) Crafts stated Article IV, on the other hand, "defines how the benefits will be paid to the employee by Hancock, various forms of annuities, the date they start and the date they end, and the forms of annuity that he can have." (*Id.* 42) Hirschberg testified similarly that Article II "is restricted to the date of coverage and the definition of the

retirement annuity," whereas Article IV covers "retirement annuity provisions, the mode of payment." (Hirschberg Tr. 30) This testimony was consistent with that of Judy Bennett, a former executive of Hancock, who drafted the 1977 amendment and made clear that Article IV, Section 9, paragraph (c) was drafted to protect Hancock. (Bennett Tr. 108, 125-26) The Court notes that by the 1977 Amendment the title of Article IV was changed to clarify its content to "Provisions Pertaining to the Payment of Benefits."

Since the alleged conflict in language between Article IV, Section 9, and Article II, Section 3, relied on by plaintiff is resolved by the underlying structure of the contract itself, as to which there is no genuine issue of material fact, plaintiff's position is rejected. Accordingly, Hancock's termination of non-guaranteed benefits in 1982 did not constitute a breach of contract.

3. Revaluation of the Rate Tables

The plaintiff next argues that Hancock breached GAC 50 by not revaluing GAC 50 rate tables (interest assumptions) with respect to pre-1968 annuities.

The provision of GAC 50 key to a determination of this issue is the second paragraph of Article III, Considerations, Section 2, Pension Administration Fund, whicn in pertinent part reads as follows:

> The Company shall re-determine on each Valuation Date on or before the date of termination of the Fund the Liabilities of the Fund, using on account of an employee, Contingent Annuitant and beneficiary to whom Retirement Annuity payments are then being made, the same rate basis and Table in Article VI as was applicable on the date an Annuity first became payable to the employee, Contingent Annuitant or beneficiary, whichever is applicable; provided, however, that with respect to any amount of annuity which was cancelled on January 1, 1968, in accordance with Section 1 of this Article, the rate basis and

Tables in Article VI which were applicable on January 1, 1968 shall be used unless otherwise agreed upon between the Employer and the Company.

GAC 50, Article III, Section 2.

Plaintiff argues that the language shows the parties contemplated a revaluation of the rate and valuation tables and that Hancock had a duty to renegotiate in good faith the application of the rate valuation tables.

The language of Article III, Section 2, is that the rate basis and tables in Article IV applicable on January 1, 1968 "*shall* be used unless otherwise agreed upon."

Such language is at most an agreement to try to agree. As such, it is not enforceable. *See Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*, 52 N.Y.2d 105, 417 N.E.2d 541, 436 N.Y.S.2d 247, 249 (1981). Accordingly, this claim of plaintiff is dismissed.

4. Assessment of Risk Charges

The plaintiff disputes Hancock's assessing a risk charge of 1% of the GAC 50 Pension Administration Fund's and the Contingency Account's share of net interest earned on Hancock's General Account. This claim rises and falls on the Court's determination of whether Hancock had an obligation to reduce excess funds by payment of non-guaranteed benefits and by permitting rollover. Since the Court has already determined Hancock's acts in connection with those two issues were permitted by the contract, this claim also fails. The 1% risk charge was permitted by the 1968 Amendment to Article III, Section 3.[13]

[13] Article III, Section 3, reads as follows:

The Company shall add to the Fund, as of each December 31st subsequent to January 1, 1968, the Fund's share and the Contingency Account's share of the net interest earned and apportioned to the Group Annuity Branch of the Company for the calendar year ending on such December 31st, less 1% of such share.

5. The Asset Liquidation Adjustment

Next, the plaintiff argues that the defendant breached GAC 50 by misapplying and miscalculating the Asset Liquidation Adjustment ("ALA"). An ALA is applied when the contractholder requests a transfer or withdrawal from defendant's General Account. The ALA is applied to adjust the transferable balance (the excess of PAF over LOF) to reflect the current market value of the assets underlying Hancock's guarantee of benefits. Debits and credits to the PAF are charged or credited to that account in dollar amounts at book value. The underlying assets, those in Hancock's General Account, however, fluctuate in market value. As interest rates vary such fluctuations can be large since the investments are overwhelmingly long-term investments. In the event a contractholder requests a transfer of the Transferable Balance (the amount by which the PAF exceeds the LOF), a formula applicable to all contracts of the same class invested in the General Account is applied to determine the Transferable Balance in order to reflect the current market value of its share of the underlying assets. This adjustment is the ALA. GAC 50, Article III, Section 9. A market value adjustment may be positive or negative. If interest rates are higher at time of transfer than on purchase of the investments, the market value adjustment is negative. *See* D. McGill, Fundamentals of Private Pensions 535 (5th ed. 1984). The Court takes judicial notice of the high interest rates prevailing in the late 1970's and early 1980's over those in previous years.

Plaintiff claims Hancock breached GAC 50 by "arbitrarily and improperly imposing and calculating an assets liquidation adjustment." Pretrial Order, Plaintiff's Contentions of Law ¶ 23(e). Plaintiff acknowledges that no transfer under the contract was ever *formally* demanded and that no ALA was ever imposed. Instead it relies on the doctrine of anticipatory breach, citing estimates of ALAs provided by Hancock. Plaintiff claims these estimates would have been misapplied or miscalculated by defendant in the event transfer was ordered by plaintiff.[14]

[14] The ALA adjustment under Article III, Section 9, was only to be made in the event an actual transfer of assets occurred (the rationale for such

(Footnote continued)

Here the plaintiff relies on an analysis by Dr. Roger Ibbotson of the Yale University School of Management which takes issue with defendant's method of calculating the ALA. The Court finds it unnecessary to assess these conflicting methodologies because plaintiff's doctrine of anticipatory breach is flawed. Plaintiff continued to treat the contract as valid and subsisting after the estimates of ALA were made by Hancock. Where a party continues to treat a contract as valid and subsisting after the alleged repudiation, it may not rely on the anticipatory breach doctrine. *Strasbourger v. Leerburger*, 233 N.Y. 55, 59, 134 N.E. 834 (1922); *North Country Rocky Point, Inc. v. Lewyt-Patchogue Co.*, 60 A.D.2d 866, 401 N.Y.S.2d 258 (App.Div.), *appeal denied*, 44 N.Y.2d 643, 376 N.E.2d 936, 405 N.Y.S.2d 1027 (1978). *See Marvel Entertainment Group, Inc. v. ARP Films, Inc.*, 684 F.Supp. 818, 820-21 (S.D.N.Y.1988).

6. Failure to Pay Dividends

The plaintiff's claim that Hancock breached GAC 50 by failing to pay any dividends from 1971-1981 is based on Article V, Section 7, which reads as follows:

> This contract is a participating Contract. The Company shall annually ascertain and apportion any divisible surplus accruing under the contracts of this class.

The parties have stipulated that:

> Hancock's Board of Directors annually votes, in its "dividend vote," to apportion and pay or allow a distribution of surplus with respect to eligible group annuity contracts and votes therein to adopt formulas for determining the distribution of such surplus.

A.S.F. ¶ 16.

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adjustment being that a transfer of assets would require a liquidation of long-term investments in the General Account). This provision defines the method of calculation of an ALA, not when it may or may not be calculable. *Cf. Police Pension Comm'n v. John Hancock Mut. Life Ins. Co.*, No. 84-3815 (E.D.Pa. July 8, 1985); Kaye Dep. at 83-89; McCarthy Dep. at 35-36; Raskin Dep. at 384.

As required by state insurance law, Hancock, as a mutual life company, annually establishes dividend formulas and determines the amount of any dividend to be paid under its participating contracts and policies, including GAC 50. A.S.F. ¶ 28.

In general, courts give directors broad discretion as to the determination of dividends and relief will only be given in the event of willful neglect or bad faith. *See Rhine v. New York Life Ins. Co.*, 273 N.Y. 1, 6 N.E.2d 74 (1936); *Kern v. John Hancock Mut. Life Ins. Co.*, 8 A.D.2d 256, 186 N.Y.S.2d 992 (App.Div. 1st Dep't 1959), *aff'd*, 8 N.Y.2d 833, 168 N.E.2d 532, 203 N.Y.S.2d 92 (1960).

Exhibits 14-22 contained in Plaintiff's Exhibit Binder filed Mar. 23, 1990, the resolutions of the directors in the years in question, are evidence of no willful neglect. Defendant contends that its calculations came out against a dividend for the GAC 50 class of contractholders because the Contingency Account was not deemed to be large enough in relation to the risks under the liabilities of the contract. Winslow Aff. dated May 7, 1990 ¶¶ 2-5. Plaintiff's conclusory assertion that dividends should have been paid because the "surplus funds were wholly unnecessary for Hancock's security," Pl.Mem. of Law in Opp. at 55, is insufficient to raise a genuine issue of material fact. *See Delaware & Hudson Ry. Co. v. Consolidated Rail Corp*, 902 F.2d 174, 178 (2d Cir.1990), *cert. denied*, – U.S. –, 111 S.Ct. 2041, 114 L.Ed.2d 125 (1991). Despite extended discovery there are no counter affidavits showing bad faith or neglect.

Under New York law "prima facie the apportionment of the divisible surplus by a mutual life insurance company must be deemed equitable," *Barnett v. Metropolitan Life Ins. Co.*, 258 A.D. 241, 245, 16 N.Y.S.2d 198, 202 (App.Div. 1st Dep't 1939), *aff'd*, 285 N.Y. 627, 33 N.E.2d 554 (1941), and plaintiff has a heavy burden to carry. *See Fidelity & Casualty Co. of New York v. Metropolitan Life Ins. Co.*, 42 Misc.2d 616, 248 N.Y.S.2d 559, 568 (N.Y.Sup.Ct.1963). Because the non-division of surplus affected all contracts of GAC 50's class and did not benefit Hancock (a mutual company); because the severe increase in interest

rates in the late 1970's would have meant a significant diminution in the market value of GAC 50 funds in the General Account carried at book value, of which the Court takes judicial notice, and because plaintiff offers no evidence of neglect or bad faith, plaintiff has failed to demonstrate that a genuine issue of material fact exists as to this claim. Accordingly, defendant's motion for summary judgment is granted.

II. *Common Law Claims*

1. Implied Covenant of Good Faith and Fair Dealing

Plaintiff argues that the totality of the circumstances surrounding Hancock's performance under GAC 50 demonstrates that Hancock has breached its covenant of good faith and fair dealing. Plaintiff's Mem. in Opp. at 57. Specifically, plaintiff objects to Hancock's termination of non-guaranteed benefits, failure to revalue rate tables for the pre-1968 annuities, refusal to permit rollover, assessment of risk charges, calculation of the ALA and failure to pay dividends, all of which relate to provisions of the GAC 50.

A covenant of good faith, however, cannot expand contract rights beyond the terms of the contract nor can a party violate that covenant when exercising its rights under the contract. *See VTR, Inc. v. Goodyear Tire & Rubber Co.*, 303 F.Supp. 773, 777-78 (S.D.N.Y.1969). *See also Keene Corp. v. Bogan*, No. 88 Civ. 0217, slip op. at 14, 1990 WL 1864 (S.D.N.Y. Jan. 11, 1990) (WESTLAW, Allfeds database) (citing *VTR, Inc.*). Good faith or lack thereof is a matter for the Court to decide. *Richard Short Oil Co. v. Texaco, Inc.*, 799 F.2d 415, 422 (8th Cir. 1986); Corbin on Contracts, § 654B at 924 (Supp.1989). The acts of defendant alleged by plaintiff since they are consonant with the contract's terms do not appear to amount to a breach of the implied duty of good faith. Plaintiff has not provided any facts showing defendant's acts were directed against plaintiff as opposed to acts carried out as ordinary corporate action.[15] Accordingly, summary judgment is granted on this issue.

[15] For over six years before the filing of this suit, Sperry received actual notice of the various components of the annual determinations made by Hancock including the directors' failure to declare any dividends, A.S.F. ¶¶ 31, 34, 49-52, Plaintiff's Admissions ¶¶ 119, 124, 129. There is no evidence of any complaint by plaintiff to the annual determinations. Under these circumstances, the doctrine of laches bars any claims against Hancock on those grounds and indeed the six-year Statute of Limitations bars such claims. Sperry's argument that these annual determinations were of a summary nature is not an adequate excuse. If the determinations were summary, plaintiff could have asked for explanations.

There remain other bad faith claims of plaintiff relating to company-wide practices of Hancock which must be considered: Hancock's investment of General Account funds in its home office building; Hancock's segmentation of assets in its General Account in 1982; and Hancock's policy of imputing bond and mortgage yields to newly-acquired common stock holdings in allocating income in the early 1970's.

Hancock's General Account into which Article I, Section 15 of GAC 50 required all Sperry's contributions be placed constituted the general corporate funds of Hancock. Absent some factual showing that a corporate investment decision regarding General Account funds was not made in a disinterested manner for the benefit of the company as a whole, which plaintiff's supporting papers do not make, plaintiff cannot challenge investments in corporate headquarters.[16] Accordingly, summary judgment is also granted on this issue.

As for segmentation, the parties have stipulated that in 1982 Hancock divided assets in its General Account into subaccounts, each having its own investment policy. A.S.F. ¶ 88. Thereafter, contracts in the subaccount including GAC 50 received investment income from assets in the so-called "Pension Participating Segment" but received no income from assets assigned to other lines of business such as guaranteed investment contracts in the "Pension Non-Participating Segment." Plaintiff claims that because in 1982 relatively more high-yield investments were assigned to the Pension Non-Participating Segment, GAC 50 was wrongfully deprived of investment income it would have received absent segmentation.

[16] Massachusetts law permits an insurance company to invest its General Account assets in home office properties. Mass.Gen.L. ch. 175, § 66B (1987 & Supp.1991).

Finally, plaintiff objects to Hancock's policy from 1971-1977 of imputing to common stock investments made in a particular year the yields on Hancock's bond and mortgage investments made for that year in the first two years of the life of those common stock investments. A.S.F. ¶¶ 60, 63. This policy raised the "new money" rate for the General Account. *Id.* ¶ 61. Plaintiff claims that this policy penalized "old" contracts such as GAC 50 heavily weighted with older assets because the rate of return credited to these accounts was reduced in order to offset the additional investment income being imputed to the "new money" investments. McCarthy Aff. ¶ 9.

Relevant to both of these claims is the following stipulation by the parties:

> With respect to Hancock's General Account, Hancock has sole authority and discretion, in accordance with and as limited by applicable laws and regulations, to establish and execute investment policy and to allocate investment income, capital gains and losses and investment expenses to particular lines of business, classes of contracts and particular contracts.

A.S.F. ¶ 12. Plaintiff has not demonstrated any violation of this authority and discretion and thus has no grounds for objecting to Hancock's segmentation or imputation policies unless some applicable law or regulation was violated. Plaintiff argues that these policies resulted in GAC 50 being treated in a discriminatory fashion and thus violated New York Insurance Law § 4224(a)(1). Plaintiff's Mem. in Opp. at 65. That section provides:

> (a) No insurance company doing business in this state and no savings and insurance bank shall:
>
> (1) make or permit any unfair discrimination between *individuals of the same class* and of equal expectation of life, in the amount or payment or return of premiums, or rates charged for policies of life insurance or annuity contracts, or in the dividends or other benefits payable thereon, or in any of the terms and conditions thereof;

N.Y. Ins. Law § 4224(a)(1) (McKinney 1985) (emphasis added). This section, like its counterpart pertaining to health insurance, § 4224(b), plainly applies to discrimination among individual insureds. *See, e.g., Health Ins. Ass'n of Am. v. Corcoran*, 154 A.D.2d 61, 551 N.Y.S.2d 615 (App.Div.) (challenging determination by State Superintendent of Insurance that use of HIV test results in screening applicants for health insurance violated § 4224), *aff'd*, 76 N.Y.2d 995, 565 N.E.2d 1264, 564 N.Y.S.2d 713 (1990); *Silver v. Equitable Life Assurance Soc'y*, 563 N.Y.S.2d 78 (App.Div.1990) (alleging that exclusionary rider discriminated against individual with congenital mental retardation). There is no allegation that Hancock unfairly discriminated among individual Sperry retirees and thus the segmentation and imputation policies were within Hancock's "sole discretion" by agreement of the parties.

2. Breach of Fiduciary Duty

Plaintiff asserts a claim for common law breach of fiduciary duty relating to Hancock's administration of GAC 50's General Account funds. Hancock argues that this claim is preempted by ERISA. ERISA's preemption provision, 29 U.S.C. § 1144, provides that ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." The Second Circuit has observed:

> [L]aws that have been ruled preempted are those that provide an alternative cause of action to employees to collect benefits protected by ERISA, refer specifically to ERISA plans and apply solely to them, or interfere with the calculation of benefits owed to an employee. Those that have not been preempted are laws of general application — often traditional exercises of state power or regulatory authority — whose effect on ERISA plans is incidental.

See Aetna Life Ins. Co. v. Borges, 869 F.2d 142, 146 (2d Cir.) (Connecticut escheat law not preempted), *cert. denied*, ___ U.S. ___, 110 S.Ct. 57, 107 L.Ed.2d 25 (1989). The Court ruled in its prior opinion that Hancock, as an insurer and issuer

of a "guaranteed benefit policy" based on its General Account assets did not have a fiduciary duty under ERISA with respect to assets held in its General Account for GAC 50 and dismissed plaintiff's ERISA claim. *See Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 722 F.Supp. 998 (S.D.N.Y.1989) (applying 29 U.S.C. § 1101(b)(2)(B)). Permitting plaintiff to assert a common law breach of fiduciary duty claim against Hancock in this context poses no danger of creating a "patchwork scheme of regulation," *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 11, 107 S.Ct. 2211, 2217, 96 L.Ed.2d 1 (1987), for employee benefit plans. *See Ventimiglia v. Gruntal & Co.*, No. 88 Civ. 1675, 1989 WL 251402 (S.D.N.Y. Nov. 1, 1989) (refusing to dismiss common law breach of fiduciary duty claim pleaded in the alternative to ERISA count but acknowledging that claim would fail if ERISA were later held to apply to the case). Such a claim is not preempted and may lie if there is evidence of a breach of fiduciary duty to the appropriate party.[17]

Plaintiff claims as a matter of case law that Hancock owed plaintiff a fiduciary duty, citing *Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co.*, 93 A.D.2d 337, 462 N.Y.S.2d 175 (App.Div. 1st Dep't 1983), *aff'd*, 61 N.Y.2d 569, 463 N.E.2d 608, 475 N.Y.S.2d 267 (1984). However, *Hartford Accident* refers to the fiduciary duty that exists "between an insurer and its assured." *Id.*, 462 N.Y.S.2d at 178. Because, as stipulated, what Hancock guaranteed was the payment of an annuity to covered employees for life (at least for any employees retiring prior to the 1977 amendment), it is clear that Sperry retirees are Hancock's only "assureds." A.S.F. ¶¶ 10, 32, 39, 80.[18] There is no

[17] Hancock would have fiduciary duties under ERISA with respect to funds not held in its General Account but held in its separate account which did not guarantee benefits but that claim is not made in this litigation.

[18] Article V, Section 1 of GAC 50 provides:

> The Company shall issue to the Retirement Committee, for delivery *to each employee covered hereunder*, an individual Certificate containing in substance a statement of the benefits to which the employee is entitled under this Contract and stating the name of the beneficiary to whom any death benefit shall be payable.

(emphasis added). These certificates are in the nature of guarantees.

showing that Hancock has violated a fiduciary duty to those employees or to any employees who retired thereafter insofar as those employees were guaranteed benefits. To the extent retirees under the Plan were required to look to the Plan assets and not to Hancock for payment of benefits, they were not Hancock's assureds. Plaintiff as trustee of the Sperry Plan is not an "assured" as to whom a common law fiduciary duty was owed by Hancock and there is no evidence showing the non-assured beneficiaries were damaged. Accordingly, this claim of plaintiff is dismissed.

3. Unjust Enrichment

Plaintiff also asserts a claim for unjust enrichment. Insofar as this claim is based on the failure to permit rollover and the assessment of risk charges on funds accumulated by reason of Hancock's termination of non-guaranteed benefits, refusal to permit rollover and its refusal to revalue rate tables for pre-1968 annuities, the claim is controlled by the express terms of the contract. Bargained-for benefits cannot be deemed to unjustly enrich a contracting party. *Cf. City of Yonkers v. Otis Elevator Co.*, 844 F.2d 42, 48 (2d Cir.1988) (quasi-contractual relief unavailable where an express contract covers the subject matter). Accordingly, plaintiff's claim for unjust enrichment is denied and defendant's motion for summary judgment dismissing that claim is granted.

CONCLUSION

Defendant's motion for summary judgment dismissing plaintiff's contract and common law claims is granted. Plaintiff's complaint now having been dismissed in its entirety, Hancock's counterclaims and its third-party complaint are dismissed as moot. This case is hereby ordered closed.

IT IS SO ORDERED

Judgment of the District Court

Harris Trust & Sav. Bank v.
John Hancock Mut. Life Ins. Co.,
833 Civ. 5401 (RPP)
(S.D.N.Y. Aug. 16, 1991)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

HARRIS TRUST & SAVINGS BANK, as Trustee of the Sperry Master Retirement Trust No. 2,

Plaintiff,

— against —

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Defendant.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Third-Party Plaintiff,

— against —

CHASE MANHATTAN BANK, N.A.,

Counterclaim Defendant,

— and —

SPERRY CORPORATION and THE RETIREMENT COMMITTEE OF SPERRY CORPORATION,

Third-Party Defendants.

83 *CIVIL* 5401 (RPP)

JUDGMENT

Defendant having moved pursuant to Rule 56, F.R.Civ.P., and the Agreed Statement of Facts stipulated by the parties on November 23, 1988 to dismiss the remaining claims of plaintiff's amended complaint, and the said motion having come before the Honorable ROBERT P. PATTERSON, U.S.D.J., and the Court thereafter on July 12, 1991, having handed down its opinion and order (#68325) and order amending opinion, dated August 8, 1991; granting defendant's motion for summary judgment dismissing plaintiff's contract and common law claims, and dismissing plaintiff's complaint in its entirety, and dismissing as moot Hancock's counterclaims and its third-party complaint, it is,

ORDERED, ADJUDGED AND DECREED: That defendant's motion for summary judgment dismissing plaintiff's contract and common law claims be and it is hereby granted, and it is further,

ORDERED, that plaintiff's complaint be and it is hereby dismissed in its entirety, and it is further,

ORDERED, that defendant's counterclaims and its third-party complaint be and they are hereby dismissed as moot.

DATED: NEW YORK, NEW YORK
August 16, 1991

/s/James M. Parkison
Clerk

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON 8-16-91.

Denial by Court of Appeals of Petition for Rehearing and Suggestion for Rehearing *In Banc*

Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.,
No. 91-7854
(2d Cir. Sept. 23, 1992)

**UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT**

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 23rd day of September on thousand nine hundred and ninety-two.

HARRIS TRUST V. JOHN HANCOCK MUTUAL

DOCKET NUMBER: 91-7854

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by Appellee JOHN HANCOCK MUTUAL LIFE INSURANCE and a brief of the AMERICAN COUNCIL OF LIFE INSURANCE, amicus curiae, having been filed in support of appellee's petition for rehearing and suggestion for rehearing in banc,

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/Elaine B. Goldsmith
ELAINE B. GOLDSMITH,
Clerk
/s/ by: Carolyn Clark Campbell
/s/ Chief Deputy Clerk

Statutes and Regulations Involved

15 U.S.C. § 1012,
29 U.S.C. § 1002(21)(A),
29 U.S.C. § 1101(b)(2),
29 U.S.C. § 1104(a)(1),
29 U.S.C. § 1144(a),
29 U.S.C. § 1144(b)(2)(A),
29 U.S.C. § 1144(d),
29 C.F.R. § 2509.75-2,
29 C.F.R. § 2510.3-101,
and
51 Fed. Reg. 41,262 (1986)

15 U.S.C. § 1012. **Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948**

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

29 U.S.C. § 1002. **Definitions**

For purposes of this subchapter:

* * *

(21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

29 U.S.C. § 1101. Coverage

* * *

(b) For purposes of this part:

* * *

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:

(A) The term "insurer" means an insurance company, insurance service, or insurance organization, qualified to do business in a State.

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contact provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

29 U.S.C. § 1104. Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and —

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

29 U.S.C. § 1144. Other laws

(a) Supersedure; effective date

Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975.

(b) Construction and application

* * *

(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

* * *

(d) Alteration, amendment, modification, invalidation, impairment, or supersedure of any law of United States prohibited

Nothing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States (except as provided in sections 1031 and 1137(b) of this title) or any rule or regulation issued under any such law.

29 C.F.R. § 2509.75-2. **Interpretive bulletin relating to prohibited transactions.**

On February 6, 1975, the Department of Labor issued an interpretive bulletin, ERISA IB 75-2, with respect to whether a party in interest has engaged in a prohibited transaction with an employee benefit plan where the party in interest has engaged in a transaction with a corporation or partnership (within the meaning of section 7701 of the Internal Revenue Code of 1954) in which the plan has invested.

On November 13, 1986 the Department published a final regulation dealing with the definition of "plan assets". See § 2510.3-101 of this title. Under that regulation, the assets of certain entities in which plans invest would include "plan assets" for purposes of the fiduciary responsibility provisions of the Act. Section 2510.3-101 applies only for purposes of identifying plan assets on or after the effective date of that section, however, and § 2510.3-101 does not apply to plan investments in certain entities that qualify for the transitional relief provided for in paragraph (k) of that section. The principles discussed in paragraph (a) of this Interpretive Bulletin continue to be applicable for purposes of identifying assets of a plan for periods prior to the effective date of § 2510.3-101 and for investments that are subject to the transitional rule in § 2510.3-101(k). Paragraphs (b) and (c) of this Interpretive Bulletin, however, relate to matters outside the scope of § 2510.3-101, and nothing in that section affects the continuing application of the principles discussed in those parts.

(a) *Principles applicable to plan investments to which § 2510.3-101 does not apply.* Generally, investment by a plan in securities (within the meaning of section 3(20) of the Employee Retirement Income Security Act of 1974) of a corporation or partnership will not, solely by reason of such investment, be considered to be an investment in the underlying assets of such corporation or partnership so as to make such assets of the entity "plan assets" and thereby make a subsequent

transaction between the party in interest and the corporation or partnership a prohibited transaction under section 406 of the Act.

For example, where a plan acquires a security of a corporation or a limited partnership interest in a partnership, a subsequent lease or sale of property between such corporation or partnership and a party in interest will not be a prohibited transaction solely by reason of the plan's investment in the corporation or partnership.

This general proposition, as applied to corporations and partnerships, is consistent with section 401(b)(1) of the Act, relating to plan investments in investment companies registered under the Investment Company Act of 1940. Under section 401(b)(1), an investment by a plan in securities of such an investment company may be made without causing, solely by reason of such investment, any of the assets of the investment company to be considered to be assets of the plan.

(b) *Contracts or policies of insurance.* If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets. Therefore, a subsequent transaction involving the general asset account between a party in interest and the insurance company will not, solely because the plan has been issued such a contract or policy of insurance, be a prohibited transaction.

(c) *Applications of the fiduciary responsibility rules.* The preceding paragraphs do not mean that an investment of plan assets in a security of a corporation or partnership may not be a prohibited transaction. For example, section 406(a)(1)(D) prohibits the direct or indirect transfer to, or use by or for the benefit of, a party in interest of any assets of the plan and section 406(b)(1) prohibits a fiduciary from dealing with the assets of the plan in his own interest or for his own account.

Thus, for example, if there is an arrangement under which a plan invests in, or retains its investment in, an investment company and as part of the arrangement it is expected that the investment company will purchase securities from a party in interest, such arrangement is a prohibited transaction.

Similarly, the purchase by a plan of an insurance policy pursuant to an arrangement under which it is expected that the insurance company will make a loan to a party in interest is a prohibited transaction.

Moreover, notwithstanding the foregoing, if a transaction between a party in interest and a plan would be a prohibited transaction, then such a transaction between a party in interest and such corporation or partnership will ordinarily be a prohibited transaction if the plan may, by itself, require the corporation or partnership to engage in such transaction.

Similarly, if a transaction between a party in interest and a plan would be a prohibited transaction, then such a transaction between a party in interest and such corporation or partnership will ordinarily be a prohibited transaction if such party in interest, together with one or more persons who are parties in interest by reason of such persons' relationship (within the meaning of section 3(14)(E) through (I)) to such party in interest may, with the aid of the plan but without the aid of any other persons, require the corporation or partnership to engage in such a transaction. However, the preceding sentence does not apply if the parties in interest engaging in the transaction, together with one or more persons who are parties in interest by reason of such persons' relationship (within the meaning of section 3(14)(E) through (I)) to such party in interest, may, by themselves, require the corporation or partnership to engage in the transaction.

Further, the Department of Labor emphasizes that it would consider a fiduciary who makes or retains an investment in a corporation or partnership for the purpose of avoiding the

application of the fiduciary responsibility provisions of the Act to be in contravention of the provisions of section 404(a) of the Act.

[51 FR 41280, Nov. 13, 1986]

29 C.F.R. § 2510.3-101 Definition of "plan assets"—plan investments.

(a) *In general.* (1) This section describes what constitute assets of a plan with respect to a plan's investment in another entity for purposes of subtitle A, and parts 1 and 4 of subtitle B, of title I of the Act and section 4975 of the Internal Revenue Code. Paragraph (a)(2) of this section contains a general rule relating to plan investments. Paragraphs (b) through (f) of this section define certain terms that are used in the application of the general rule. Paragraph (g) of this section describes how the rules in this section are to be applied when a plan owns property jointly with others or where it acquires an equity interest whose value relates solely to identified assets of an issuer. Paragraph (h) of this section contains special rules relating to particular kinds of plan investments. Paragraph (i) describes the assets that a plan acquires when it purchases certain guaranteed mortgage certificates. Paragraph (j) of this section contains examples illustrating the operation of this section. The effective date of this section is set forth in paragraph (k) of this section.

(2) Generally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity. However, in the case of a plan's investment in an equity interest of an entity that is neither a publicly-offered security nor a security issued by an investment company registered under the Investment Company Act of 1940 its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity, unless it is established that —

(i) The entity is an operating company, or

(ii) Equity participation in the entity by benefit plan investors is not significant.

Therefore, any person who exercises authority or control respecting the management or disposition of such underlying assets, and any person who provides investment advice with respect to such assets for a fee (direct or indirect), is a fiduciary of the investing plan.

(b) *Equity interests and publicly-offered securities.* (1) The term *equity interest* means any interest in an entity other than an instrument that is treated as indebtedness under applicable local law and which has no substantial equity features. A profits interest in a partnership, an undivided ownership interest in property and a beneficial interest in a trust are equity interests.

(2) A *publicly-offered security* is a security that is freely transferable, part of a class of securities that is widely held and either –

(i) Part of a class of securities registered under section 12(b) or 12(g) of the Securities Exchange Act of 1934, or

(ii) Sold to the plan as part of an offering of securities to the public pursuant to an effective registration statement under the Securities Act of 1933 and the class of securities of which such security is a part is registered under the Securities Exchange Act of 1934 within 120 days (or such later time as may be allowed by the Securities and Exchange Commission) after the end of the fiscal year of the issuer during which the offering of such securities to the public occurred.

(3) For purposes of paragraph (b)(2) of this section, a class of securities is "widely-held" only if it is a class of securities that is owned by 100 or more investors independent of the issuer and of one another. A class of securities will not fail to be widely-held solely because subsequent to the initial offering the number of independent investors falls below 100 as a result of events beyond the control of the issuer.

(4) For purposes of paragraph (b)(2) of this section, whether a security is "freely transferable" is a factual question to be determined on the basis of all relevant facts and circumstances. If a security is part of an offering in which the minimum investment is $10,000 or less, however, the following factors ordinarily will not, alone or in combination, affect a finding that such securities are freely transferable:

(i) Any requirement that not less than a minimum number of shares or units of such security be transferred or assigned by any investor, provided that such requirement does not prevent transfer of all of the then remaining shares or units held by an investor;

(ii) Any prohibition against transfer or assignment of such security or rights in respect thereof to an ineligible or unsuitable investor;

(iii) Any restriction on, or prohibition against, any transfer or assignment which would either result in a termination or reclassification of the entity for Federal or state tax purposes or which would violate any state or Federal statute, regulation, court order, judicial decree, or rule of law;

(iv) Any requirement that reasonable transfer or administrative fees be paid in connection with a transfer or assignment;

(v) Any requirement that advance notice of a transfer or assignment be given to the entity and any requirement regarding execution of documentation evidencing such transfer or assignment (including documentation setting forth representations from either or both of the transferor or transferee as to compliance with any restriction or requirement described in this paragraph (b)(4) of this section or requiring compliance with the entity's governing instruments);

(vi) Any restriction on substitution of an assignee as a limited partner of a partnership, including a general partner consent requirement, provided that the economic benefits of ownership

of the assignor may be transferred or assigned without regard to such restriction or consent (other than compliance with any other restriction described in this paragraph (b)(4)) of this section;

(vii) Any administrative procedure which establishes an effective date, or an event, such as the completion of the offering, prior to which a transfer or assignment will not be effective; and

(viii) Any limitation or restriction on transfer or assignment which is not created or imposed by the issuer or any person acting for or on behalf of such issuer.

(c) *Operating company.* (1) An "operating company" is an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale of a product or service other than the investment of capital. The term "operating company" includes an entity which is not described in the preceding sentence, but which is a "venture capital operating company" described in paragraph (d) or a "real estate operating company" described in paragraph (e).

* * *

(h) *Specific rules relating to plan investments.* Notwithstanding any other provision of this section—

(1) Except where the entity is an investment company registered under the Investment Company Act of 1940, when a plan acquires or holds an interest in any of the following entities its assets include its investment and an undivided interest in each of the underlying assets of the entity:

(i) A group trust which is exempt from taxation under section 501(a) of the Internal Revenue Code pursuant to the principles of Rev. Rul. 81-100, 1981-1 C.B. 326,

(ii) A common or collective trust fund of a bank,

(iii) A separate account of an insurance company, other than a separate account that is maintained solely in connection with fixed contractual obligations of the insurance company under which the amounts payable, or credited, to the plan and to any participant or beneficiary of the plan (including an annuitant) are not affected in any manner by the investment performance of the separate account.

(2) When a plan acquires or holds an interest in any entity (other than an insurance company licensed to do business in a State) which is established or maintained for the purpose of offering or providing any benefit described in section 3(1) or section 3(2) of the Act to participants or beneficiaries of the investing plan, its assets will include its investment and an undivided interest in the underlying assets of that entity.

(3) When a plan or a related group of plans owns all of the outstanding equity interests (other than director's qualifying shares) in an entity, its assets include those equity interests and all of the underlying assets of the entity. This paragraph (h)(3) does not apply, however, where all of the outstanding equity interests in an entity are qualifying employer securities described in section 407(d)(5) of the Act, owned by one or more eligible individual account plan(s) (as defined in section 407(d)(3) of the Act) maintained by the same employer, provided that substantially all of the participants in the plan(s) are, or have been, employed by the issuer of such securities or by members of a group of affiliated corporations (as determined under section 407(d)(7) of the Act) of which the issuer is a member.

(4) For purposes of paragraph (h)(3), a "related group" of employee benefit plans consists of every group of two or more employee benefit plans—

(i) Each of which receives 10 percent or more of its aggregate contributions from the same employer or from members of the same controlled group of corporations (as determined under section 1563(a) of the Internal Revenue Code, without regard to section 1563(a)(4) thereof); or

(ii) Each of which is either maintained by, or maintained pursuant to a collective bargaining agreement negotiated by, the same employee organization or affiliated employee organizations. For purposes of this paragraph, an "affiliate" of an employee organization means any person controlling, controlled by, or under common control with such organization, and includes any organization chartered by the same parent body, or governed by the same constitution and bylaws, or having the relation of parent and subordinate.

* * *

(k) *Effective date and transitional rules.* (1) In general, this section is effective for purposes of identifying the assets of a plan on or after March 13, 1987. Except as a defense, this section shall not apply to investments in an entity in existence on March 13, 1987, if no plan subject to title I of the Act or plan described in section 4975(e)(1) of the Code (other than a plan described in section 4975(g)(2) or (3)) acquires an interest in the entity from an issuer or underwriter at any time on or after March 13, 1987 except pursuant to a contract binding on the plan in effect on March 13, 1987 with an issuer or underwriter to acquire an interest in the entity.

(2) Notwithstanding paragraph (k)(1), this section shall not, except as a defense, apply to a real estate entity described in section 11018(a) of Pub. L. 99-272.

[51 FR 41280, Nov. 13, 1986, as amended at 51 FR 47226, Dec. 31, 1986]

DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

29 CFR Parts 2509, 2510, and 2550

Final Regulation Relating to the Definition of Plan Assets

AGENCY: Department of Labor.

ACTION: Final regulation.

SUMMARY: This document contains a final regulation that describes what constitute assets of a plan for purposes of certain provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA, or the Act) and the related prohibited transaction provisions of the Internal Revenue Code (the Code). This document also contains a redesignation of the rule relating to guaranteed governmental mortgage pool certificates that was originally codified at 29 CFR 2550.401b-1. There has been considerable uncertainty regarding what constitute "plan assets" for purposes of ERISA, and the regulation will provide guidance to plan fiduciaries, participants and beneficiaries of plans and other affected parties.

* * *

Background

I. History of the Regulation

On January 8, 1985, the Department of Labor (the Department) published a notice in the Federal Register containing a proposed regulation that would characterize the assets of certain entities in which plans invest as including plan assets, with the result that the managers of those entities would be considered "fiduciaries" subject to the fiduciary responsibility provisions of ERISA.[1] The notice gave an opportunity for interested persons to comment on the proposal.

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[1] Proposed regulation 29 CFR 2510.3-101 (50 FR 961). That document also gave notice of withdrawal of a previously proposed regulation (45 FR 38084, June 6, 1980) and the withdrawal of most of the provisions of another previously proposed regulation (44 FR 50363, August 28, 1979) both of which dealt with the definition of plan assets. The Department also noted that the regulation, if adopted, would contain a revision and clarification of Interpretive Bulletin 75-2 (29 CFR 2509.75-2).

On February 15, 1985, the Department published a notice in the Federal Register containing an amendment modifying the effective date provision of the proposed regulation.[2]

A public hearing on the proposal was held in Washington, DC, on May 6, 7 and 8, 1985 at which time more than 45 commentators made oral presentations. At the conclusion of the hearing, the record in the proceeding was held open until June 30, 1985, in order to permit the filing of additional submissions.[3]

The Department has received more than 700 letters of comment regarding the proposal. The final regulation has been substantially revised in response to the comments received and the testimony at the public hearing.

The following discussion summarizes the proposed regulation and the major issues raised by the commentators and explains the Department's reasons for adopting the final regulation that is published with this notice.

II. Overview of the "Plan Assets" Issue

The proposed plan assets regulation described the circumstances under which the assets of an entity in which a plan invests will be considered to include "plan assets" so that the manager of the entity would be subject to the fiduciary responsibility rules of ERISA. Under ERISA, persons who exercise discretionary authority or control over the assets of a plan or who provide investment advice for a fee with respect to such assets are "fiduciaries" subject to the fiduciary responsibility provisions of the Act.[4] Thus, identifying a plan's assets is a critical step in identifying plan fiduciaries. Moreover, the fiduciary responsibility provisions of ERISA include prohibited transaction provisions which restrict the manner in which fiduciaries may deal with the assets of a plan.[5] In general, a fiduciary may not use the assets of a plan to engage in transactions with "parties in interest" to the plan or plans for which he is acting.

[2] 50 FR 6362.

[3] Transcript of Hearing for May 8, 1985, at 110.

[4] See section 3(21) of ERISA.

In ERISA, the term "fiduciary" is defined broadly and in functional terms. Fiduciary status is determined with reference to a person's activities with respect to a plan; it does not depend upon any formal undertaking or agreement.[6] In the Department's view, there are many situations where a plan, although nominally investing its assets in a separate entity, is as a practical matter retaining the persons who manage the entity to provide investment management services for the plan. For example, some institutional managers – such as banks and insurance companies – have traditionally pooled the assets of several plans for purposes of collective investment, and plans typically participate in such a fund by acquiring investment units evidencing an interest in the fund. More recently, limited partnerships have been used as devices for the collective investment of plan assets.

Although ERISA does not explicitly define what constitute "plan assets", it does deal specifically with certain kinds of collective investment arrangements. Section 401(b)(1) of ERISA provides that, in the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of the plan will be deemed to include such security, but will not, solely by reason of the plan's acquisition of the security, be deemed to include any assets of the investment company.[7] Similarly, section 401(b)(2) of ERISA

[5] See section 406 of ERISA. The prohibited transaction provisions of ERISA are complemented by section 4975 of the Code which imposes an excise tax on disqualified persons who engage in prohibited transactions.

[6] See H.R. Rep. No. 1280, 93d Cong., 2d Sess., 323 (1974) (the Conference Report).

[7] The Conference Report indicates that this statutory exclusion was included in ERISA in view of the existence of regulation under the Investment Company Act and because interests in registered investment companies must be widely held. Conference Report at 296. Section 3(21)(B) of ERISA also indicates that neither a registered investment company, its investment adviser nor its principal underwriter is deemed to be a fiduciary by reason of a plan's investment in the investment company, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of such company, adviser or underwriter.

provides that when a plan acquires a "guaranteed benefit policy" from an insurance company, the assets of the plan include the policy, but do not include any of the underlying assets of the insurance company issuing the policy.

ERISA also includes provisions which indicate that the underlying assets of certain kinds of collective funds do include "plan assets."[8] Thus, the Act contains special reporting and disclosure provisions where some or all of the assets of a plan are held in an insurance company separate account or a bank common or collective trust fund.[9] In addition, the legislative history accompanying ERISA clearly indicates that the assets of such traditional investment funds should be considered "plan assets" subject to the fiduciary responsibility rules of the Act.[10]

In the Department's view, it would be unreasonable to suppose that Congress intended that the protections of the fiduciary responsibility provisions of the Act which are applicable where a plan directly retains a manager of its investments would not be applicable where the manager is retained indirectly through investment by the plan in a collective investment fund. It would also appear to be inconsistent with the broad functional definition of "fiduciary" in ERISA if persons who provide services that would cause them to be fiduciaries if the services were provided directly to plans are able to circumvent the fiduciary responsibility rules of the Act by the interposition of a separate legal entity between themselves and the plans (for example, by providing

[8] In such case, a plan's assets would include its interest in the fund and an undivided interest in each of the underlying assets of the fund.

[9] Section 103(b)(3)(C) of the Act.

[10] "[I]nsurance companies are to be responsible under the general fiduciary rules with respect to assets held under separate account contracts and the assets of these contracts are to be considered as plan assets. . ." Conference Report, at 296. "The conferees understand that it is common practice for banks, trust companies and insurance companies to maintain pooled investment funds for plans. . . . Banks, etc. that operate such pooled investment funds are, of course, plan fiduciaries." Conference Report, at 316.

services to a limited partnership in which plans invest). However, neither ERISA itself nor the legislative history of the Act provides a clear indication of the extent to which the fiduciary responsibility provisions of the Act are intended to apply when a plan invests in another entity which may be a vehicle for collective investment of plan funds. In developing a regulation to address this issue the Department has taken into account the public comments on the proposed regulation and the testimony at the public hearing, the express statutory provisions of ERISA, the relevant legislative history and the existing federal regulatory structure applicable to entities in which plans invest.

III. Description of the Proposed Regulation

In order to determine when an investment is an arrangement for the indirect provision of investment management services, the proposed regulation established a "look-through" rule pursuant to which a plan would, in cases where the rule applies, be considered to have acquired an interest in the underlying assets of an entity in which it invests so that the assets of the entity would include "plan assets." To define the scope of the look-through rule, the proposed regulation also established a series of exceptions to the rule. The proposed regulation reflected a general policy determination that the fiduciary responsibility provisions of the Act should apply to an entity in which a plan invests only if: (1) The plan's investment is such that it has an opportunity to participate in the earnings of the entity; (2) the entity itself is an investment fund; and (3) there is some indication that interests in the entity are offered especially to plans. Although, as discussed below, the Department has made several modifications to the regulation in response to the comments received, this general policy approach is reflected in the final regulation.

The first exclusion in the proposed regulation was for plan investments that are not "equity interests". This exclusion reflected a determination that only those investments which provide a plan with an opportunity to share in the success or failure of the entity to which the investment relates are likely to be vehicles for the indirect provision of investment management services. Under the proposal, "equity interests" were defined

generally as interests in an entity other than instruments which are treated as indebtedness under local law and which have no substantial equity features.

The second exclusion was for "publicly-offered" securities, that is securities that are registered under the federal securities acts and which are widely-held and freely transferable. The exclusion did not extend to securities that are offered primarily to tax exempt investors.

The third exclusion was for entities in which there was no "significant" plan investment. This exclusion was intended to deal with investments in entities in which there has been no special solicitation of plan investors. Under the proposal, plan investment was "significant" if ERISA plans and certain other kinds of benefit plans own more than 20 percent of any class of outstanding equity interests in an entity.

The fourth exclusion related to "operating companies"—companies that are primarily engaged in the production or sale of a product or service other than the investment of capital. The proposal also specifically described certain "real estate operating companies" and "venture capital operating companies" which were treated as operating companies.

The proposed regulation also provided that the assets of certain entities would always include "plan assets." These included bank collective trust funds, most insurance company separate accounts and entities that are wholly owned by plans. The proposal also provided that the assets of entities, other than insurance companies licensed to do business in a state, that are established for the purpose of providing benefits to participants of investing plans would include plan assets. This provision was intended to apply primarily to so-called "multiple employer trusts."

As proposed, the plan assets regulation would have been effective 90 days after it was published in final form. Under a transitional rule, however, the regulation would not apply to entities which accepted no new plan investments after June 30, 1986.

The Final Regulation

* * *

IX. Revision and Clarification of Interpretive Bulletin 75-2

As indicated in the preamble to the proposed regulation, the Department has revised Interpretive Bulletin 75-2 to coordinate it with the final regulation. As revised, the interpretive bulletin indicates that the rules established by the final "plan assets" regulation apply only for purposes of identifying plan assets on or after the effective date of the regulation and that the interpretive bulletin is effective for periods prior to that date and for investments that are subject to the transitional rule.

The remainder of the Interpretive Bulletin which discusses certain prohibited transactions under section 406 of ERISA (and section 4975 of the Code), is not affected by the final "plan assets" regulation. Also, the Department notes that the portion of Interpretive Bulletin 75-2 dealing with contracts or policies of insurance is not affected by the regulation being issued here.

The Department does not intend to effect any substantive change in the rules in the interpretive bulletin by making these revisions.[43]

* * *

[43] In this regard, the Department notes that the final paragraph of Interpretive Bulletin 75-2 states that the Department would consider a fiduciary who makes or retains an investment in a corporation or partnership for the purpose of avoiding the application of the fiduciary responsibility provisions of the Act to be in contravention of the provisions of section 404(a) of the Act. However, it is the Department's view that the mere fact a fiduciary makes or retains an investment in a corporation or partnership which does not hold plan assets under the final regulation does not mean the fiduciary has engaged in a transaction for the purposes of avoiding the application of the fiduciary responsibility rules within the meaning of the final paragraph of Interpretive Bulletin 75-2.